Developments in selected CESEE countries

Solid economic momentum on the back of vivid consumption dynamics[1,2]

1 Regional overview

Supportive international economic environment despite challenging political developments

The international political environment of the CESEE countries is characterized by a high degree of uncertainty. A number of recent events have contested some of the building blocks of political order in Europe: Brexit was a setback for European integration and put an end to the move toward an "ever closer union." The high numbers of refugee arrivals in 2015 and early 2016 challenged the free movement of persons and thus one of the basic freedoms of the European Single Market. This might prove especially harmful for CESEE, as nationals of most CESEE countries have taken advantage of the possibility of free relocation within the EU. Furthermore, noncompliance with refugee allocation plans might impact future EU funding for the region. In addition, the election of Donald Trump as U.S. president might entail major disruptions in the global trade and security architecture. Finally, the 2016 coup d'état attempt in Turkey might cause a major setback in EU enlargement and necessitate the recalibration of the EU's neighborhood policy.

So far, however, these political events have not substantially impacted the international economic environment of the CESEE region. After a rollercoaster ride in the first half of 2016, financial market sentiment strengthened in the review period. In fact, equity prices in the advanced economies increased notably in recent months. In part, this rebound reflects expectations of a major fiscal stimulus in the United States, but also solid fundamentals: Sentiment brightened, initial Brexit concerns eased, global trade picked up speed, deflation fears ebbed and inflation concerns have not yet set in, and the economic outlook has improved. The second half of 2016 witnessed a rather broad-based economic recovery in the euro area. Average growth rates of 0.4% and 0.5% (quarter on quarter, seasonally adjusted) in the third and fourth quarters brought full-year euro area growth to a total of 1.8% in 2016.

Solid growth especially in the final quarter of 2016

Against this background, growth in the CESEE region was generally solid in the second half of 2016. After a temporary setback in the third quarter (mainly owing to lower growth contributions of net exports in some of the region's bigger markets), growth accelerated strongly in the final quarter of 2016. This recovery was broad based. Among the CESEE EU Member States, economic conditions were especially favorable in Slovenia, Poland and Romania: Growth rates of above 1% in the fourth quarter (quarter on quarter, seasonally adjusted) secured them a top position among the fastest growing countries in the EU. There are indications that GDP growth also picked up in Russia in the third and fourth quarters of 2016, putting an end to the recession that had started back in 2014. The Russian recov-

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[2] *Cutoff date: April 7, 2017. This report focuses primarily on data releases and developments from October 2016 up to the cutoff date and covers Slovakia, Slovenia, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Turkey and Russia. The countries are ranked according to their level of EU integration (euro area countries, EU Member States, EU candidate countries and non-EU countries). For statistical information on selected economic indicators for CESEE countries not covered in this report (Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, Serbia and Ukraine), see the statistical annex in this issue.*

ery was driven mainly by positive impulses from the external sector, while negative growth contributions of domestic demand diminished.

Dynamics were especially pronounced in Turkey, however. Skyrocketing growth in the final quarter of 2016 was partly related to a weak third quarter: Rising political uncertainty in connection with the failed coup in mid-2016 and the strained security situation had a negative impact on capital formation and the tourism sector and sent the Turkish lira on a downward trend. Accordingly, GDP decreased by 0.2% (quarter on quarter). The strong acceleration of GDP growth in the final quarter of 2016 was driven especially by private consumption, which benefited from a surge in budget transfers to households. Future developments in Turkey will certainly be influenced by the outcome of the constitutional referendum of April 16, 2017, regarding the establishment of an executive presidency and by the possible impacts the result might have on Turkey's relations with the EU.

Table 1

Real GDP growth

	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Period-on-period change in %							
Slovakia	3.8	3.3	1.1	1.0	0.6	0.8	0.7	0.8
Slovenia	2.3	2.5	0.2	0.5	0.6	0.7	1.0	1.2
Bulgaria	3.6	3.4	0.9	0.9	0.8	0.9	0.7	0.9
Croatia	1.6	2.9	0.7	–0.2	0.8	0.9	1.2	0.6
Czech Republic	4.5	2.4	1.0	0.3	0.4	0.9	0.2	0.4
Hungary	3.1	2.0	0.6	0.9	–0.3	1.0	0.3	0.4
Poland	3.9	2.8	1.2	1.0	0.0	1.0	0.4	1.7
Romania	3.9	4.8	1.9	0.9	1.3	1.6	0.6	1.4
Turkey	6.1	2.9	1.3	0.7	0.8	0.2	–0.2	3.8
Russia	–2.8	–0.2	..	..	..	..	..	..
Euro area	2.0	1.8	0.3	0.4	0.6	0.3	0.4	0.5

Source: Eurostat, national statistical offices.

All CESEE countries except Russia outpaced the euro area in terms of growth in 2016. This means the region's catching-up process continued throughout the review period. It must be noted, however, that progress with catching up remains heterogeneous across the CESEE countries. For example, Croatia and Slovenia have not yet reached their precrisis output levels, while all other CESEE countries (and the euro area) did so several years ago. Furthermore, GDP per capita (at PPP) is still notably below euro area levels in all CESEE countries, ranging from 48.6% in Bulgaria to 79.4% in the Czech Republic.

Consumption thrives as labor market conditions improve

Private consumption remained the most important pillar of growth especially in the CESEE EU Member States. It benefited from two factors in particular: improving labor market conditions and rising real wages, which had a positive impact on consumer sentiment. Consumer sentiment as measured by the European Commission's Economic Sentiment Indicator (ESI) advanced by four points in the review period and reached a historical high in early 2017.

Unemployment rates have been falling consistently since early 2013 in most CESEE countries, in some of which substantially so. For example, Hungary's unemployment rate in seasonally adjusted terms declined from a peak value of

11.4% in February 2012 to 4.3% in January 2017, the lowest rate since recording started in 1996. The Czech Republic chalked up an unemployment rate of 3.4% in February 2017, the lowest rate in the EU. Positive labor market developments are also substantiated by several other indicators: Unemployment also declined among the most vulnerable age cohorts, namely young persons (below 25 years) and older persons (above 50 years). Very recently, a positive and rather broad-based trend was observable in long-term unemployment. Employment expanded strongly especially in Slovakia, Hungary and the Czech Republic. It stagnated in Poland and declined somewhat in Romania and Bulgaria, however. These three countries are also the countries that reported a notable decline in the labor force, which suggests that outward migration might still play a role for some CESEE labor markets. At the same time, especially skilled labor is becoming increasingly scarce, contributing further to the tightening of labor market conditions.

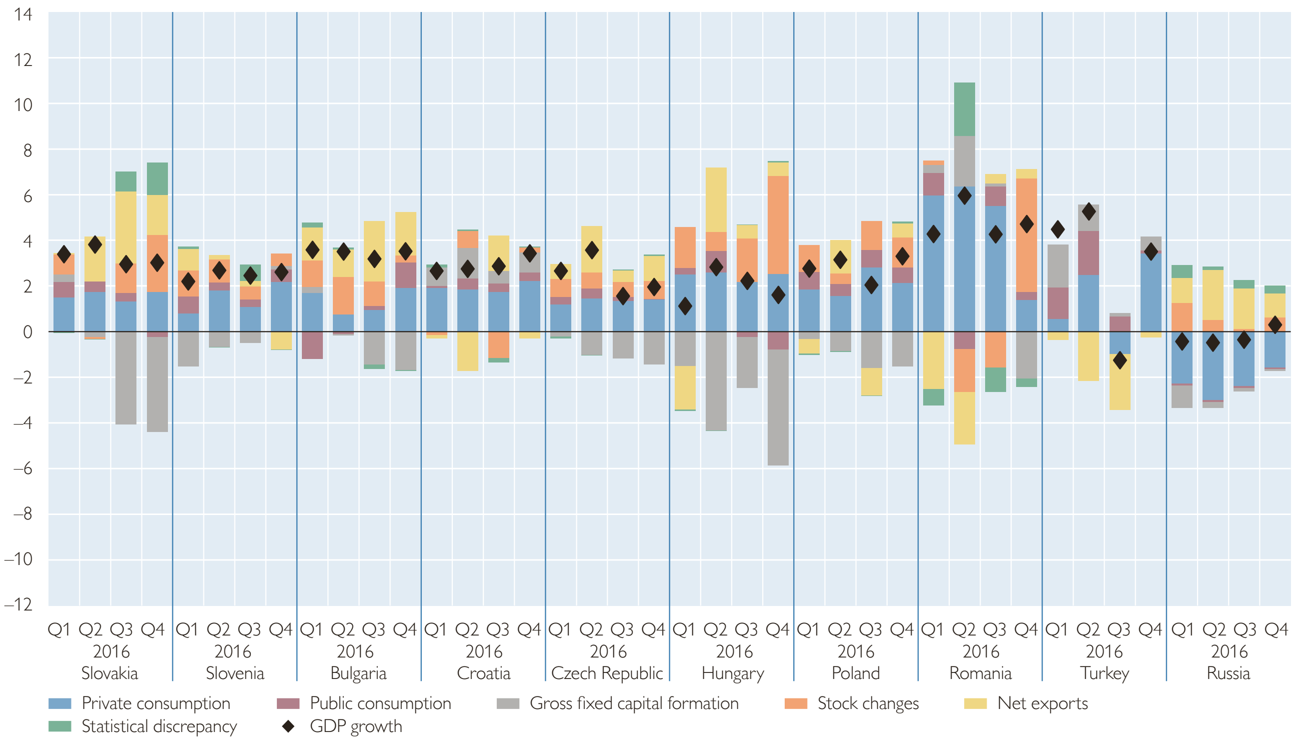
Nominal wages rose powerfully in the review period, going up by around 6% per annum, on average, in the second half of 2016 from 4.5% in the first half. Romania even reported double-digit wage increases (caused by a minimum wage hike, among other things). Slowly rising inflation rates somewhat cut into purchasing power in the fourth quarter of 2016. Nevertheless, real wages advanced by some 5% in late 2016. Strong wage inflation has already caused competitiveness in several countries to deteriorate and might also be a sign of overheating in some.

Gross fixed capital formation continued to affect general economic dynamics in the review period. This was especially true for the EU Member States in the

Chart 1

GDP growth and its main components

Percentage points, GDP growth in % (year on year)



Source: Eurostat, national statistical offices.

sample, where the contraction of investment intensified to an average of –6.7% in the second half of 2016 (–1.8% in the first half). However, outcomes showed a wide dispersion, with growth rates ranging between +4.6% in Croatia and –19.6% in Hungary in the fourth quarter of 2016. The general drop in investment was related to the end of the final year of overlapping programing periods for the disbursement of EU funds in 2015. Against this background, public investment and investment in construction suffered in particular. At the same time, stock changes contributed positively to GDP growth in all EU Member States, with inventory buildup signaling positive sentiment and expectations for the future.

Low EU fund disbursements continue to hamper investment

In Turkey, investment growth weakened, too, and turned negative (year on year) in the third quarter of 2016. Capital formation has been softening for several quarters against the background of political uncertainty and security risks in the country. By contrast, the contraction of investment in Russia moderated in the review period.

External sector supports growth despite weakening price competitiveness

The external sector's contribution to growth was positive but minor in most countries under observation. Exports benefited from robust external demand and accelerated somewhat throughout the year. At the same time, import demand was strong, given the dynamic development of private consumption. Notable growth contributions from net exports were only reported for Slovakia, Bulgaria and Russia. Slovakia and Bulgaria managed to keep import growth in check, while in Russia imports even contracted against the background of still weak domestic demand.

The external sector performed reasonably well given the fact that unit labor costs (ULCs) in manufacturing (measured in euro) deteriorated throughout most of the region. This development was driven by pronounced increases in labor costs, reflecting tightening labor market conditions. Except in Slovenia, productivity advances were not sufficient to counteract these wage rises. As most regional currencies traded at a broadly stable rate against the euro in the review period, this translated into a loss of price competitiveness vis-à-vis the euro area. Some more pronounced depreciation, however, helped bolster competitiveness to a certain extent in Poland and Turkey. Positive export developments in connection with declining price competitiveness as measured by ULCs suggest that CESEE export sectors were successful in improving non-price competitiveness factors.

High-frequency and sentiment indicators point toward continued solid growth

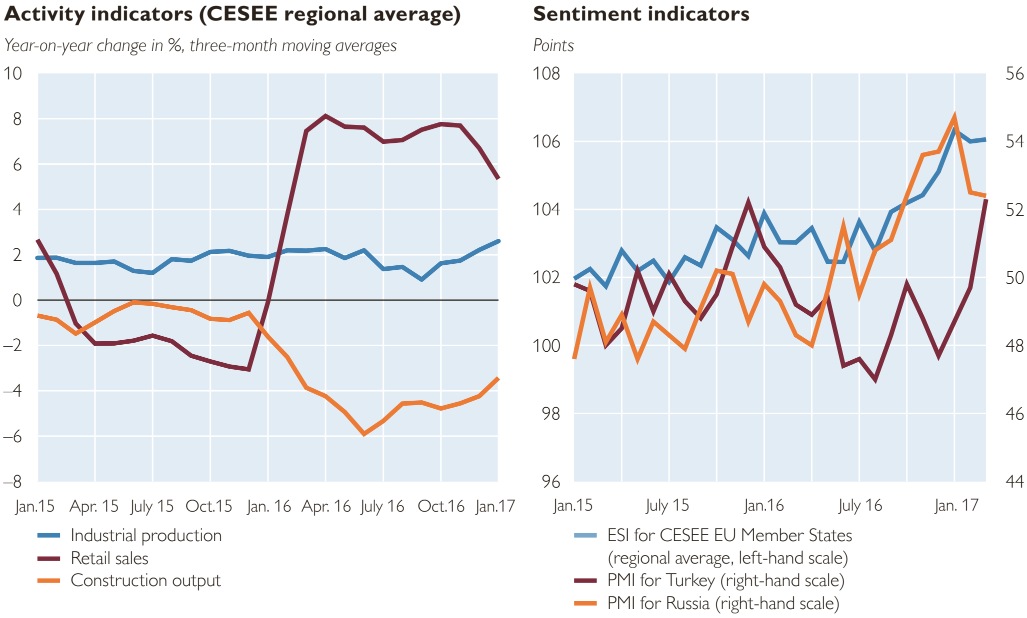
The picture derived from high-frequency activity indicators is mixed but generally positive. Industrial production has displayed a favorable trend since summer 2016. Output growth accelerated during recent months, and industrial production in CESEE expanded by 2.6% on average in January 2017 – the highest reading since mid-2014. Industry sales figures show that most of this growth was fueled by foreign demand.

Mirroring the dynamics of industrial output, output in construction also recovered from its trough in mid-2016. Its growth rate accelerated from –5.9% in June 2016 to –3.4% in January 2017. Construction production, however, is still hampered by reduced disbursements of EU funds and continued to decline in the review period. It should pick up speed once new projects have been submitted and decided upon for EU co-financing.

The growth of retail sales decelerated notably in the review period, coming down from around 8% in October 2016 to 5.3% in January 2017. Weakening dynamics were observed especially in the larger CESEE markets (Russia, Turkey

Chart 2

Leading indicators



Source: Eurostat, wiiw, European Commission, Markit.

and Poland), which strongly impacted on the regional average. Nevertheless, retail sale growth was positive in all CESEE countries except Turkey.

Economic sentiment developed favorably in general, especially in the CESEE EU Member States, thus mirroring robust economic dynamics. The ESI (average for the CESEE EU Member States) stood at levels substantially above its long-term average throughout the review period. In January 2017, it even peaked at above 106 points, and it remained at this elevated level in February and March 2017, recording the highest reading since early 2008. Increases in the index were led by sentiment in construction and consumer sentiment. All other components of the index, however, developed positively, too. The Purchasing Managers' Index (PMI) for Russia corroborates the improving state of the Russian economy. It increased to above 50 points (the threshold indicating an expansion) in August 2016 and remained above this threshold until the end of the review period.

Negative sentiment readings were only reported for Turkey. The PMI remained below 50 points between March 2016 and February 2017 before – somewhat surprisingly – jumping to above 52 points in March 2017. Lately, the ESI for Turkey also increased, but this increase was much less pronounced than that of the PMI. The ESI advanced to 93.7 points in March 2017 and remained far below its long-term average. The improvement was driven mainly by industry and construction.

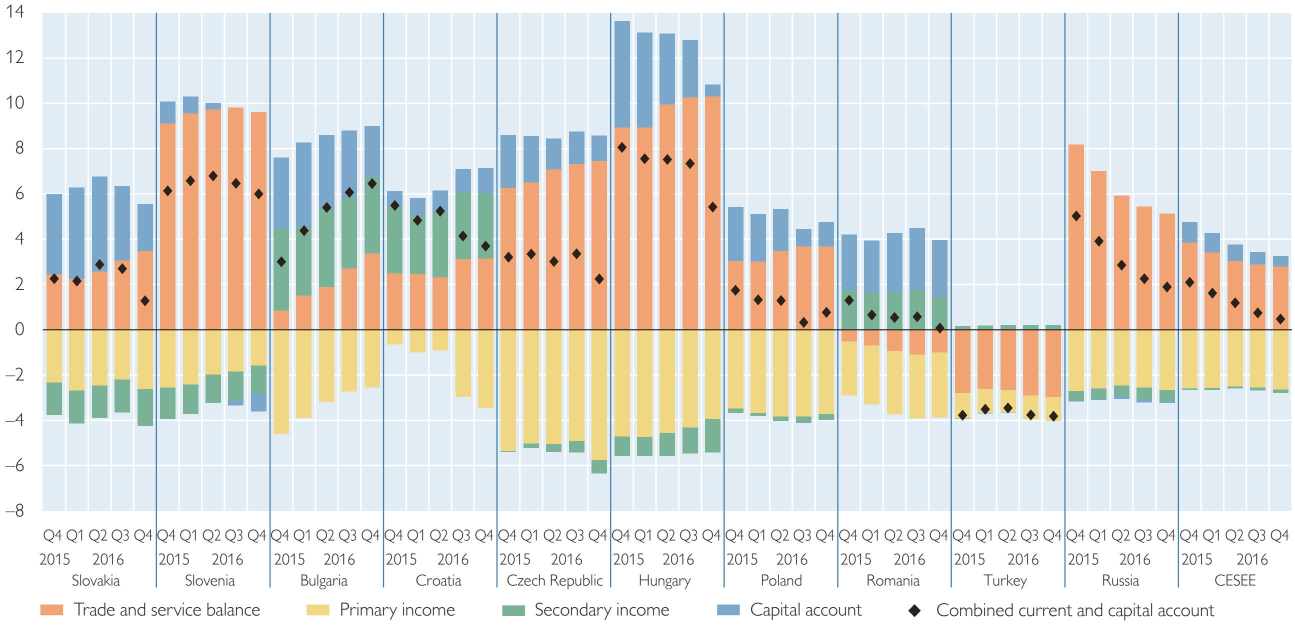
Lower capital account surplus weighs on CESEE's external surplus

The combined current and capital account balance for CESEE as a whole deteriorated somewhat in the review period, decreasing from a surplus of 1.2% of GDP in the second quarter of 2016 to 0.5% of GDP in the fourth quarter of 2016 (four-quarter moving sums). This development was mainly driven by a lower surplus in the capital account related to lower EU funds flowing into the region.

Chart 3

Combined current and capital account balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

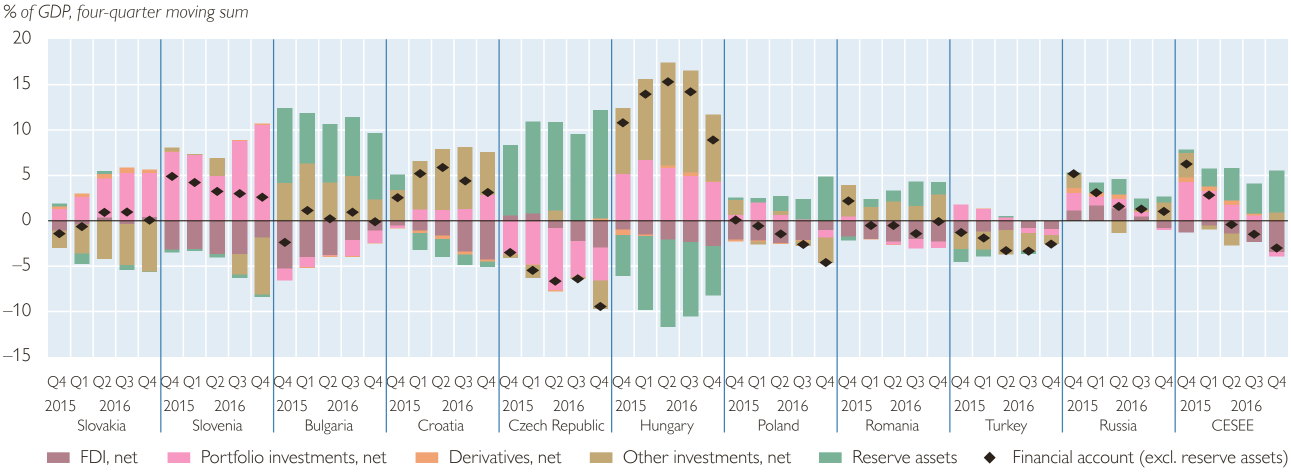
While the trade and service balance was also somewhat lower than in the first half of 2016, the other components of the current account remained broadly unchanged.

With the exception of Bulgaria, all countries of the region reported a lower surplus in the combined current and capital account. This development was most pronounced in Hungary, followed by Slovakia and Croatia. In Hungary and Slovakia, capital account dynamics sufficiently explain the development of the combined current and capital account. Croatia reported an increasing deficit in the primary income balance (comprising factor income such as income from loans and investments) as profit repatriations of foreign-owned companies shot up. Bulgaria's favorable performance was above all related to a rising surplus in the goods and services balance, which reflected positive terms of trade developments as well as an exceptionally good tourism season. Furthermore, the deficit in primary income contracted notably as a result of lower outflows under the dividend and distributed profit subitem.

The aggregate financial account balance (i.e. the difference between the net acquisition of assets and the net incurrence of liabilities, excluding reserves) of the ten CESEE countries as a whole declined from –0.5% of GDP in the second quarter of 2016 to –3% of GDP in the fourth quarter of 2016. Accordingly, their net acquisition of assets was markedly lower than their net incurrence of liabilities. This development was driven by FDI and portfolio investments. In both categories, the CESEE region is a net debtor vis-à-vis the rest of the world. At the same time, the balance of other investments turned positive, implying a net buildup of other investment assets. The financial account deteriorated especially in Hungary, Poland, Croatia and the Czech Republic. In the other CESEE countries, the finan-

Chart 4

Financial account balance



Source: National central banks.

cial account balance remained broadly stable in the review period, with changes ranging between –0.9% of GDP in Slovakia and +0.7% of GDP in Turkey.

Deflationary period ends

Inflation rates displayed a clear upward trend in CESEE throughout the review period. The only exception from this pattern was Russia, where price rises came down from rather high levels as the Russian ruble appreciated in recent months and food price inflation stabilized against the background of a bumper harvest.

After a prolonged period of deflation, prices started to increase in the CESEE EU Member States, mainly on the back of rising energy prices. The other HICP components generally did not add much to price developments. Only the Czech Republic, Croatia and Slovakia reported stronger pressure from food prices. Against this background, inflation ranged from 0.5% in Romania to 2.9% in Hungary in February 2017. This corresponds to an average increase in inflation of about 2 percentage points since the third quarter of 2016 throughout CESEE.

At the same time, core inflation (excluding energy and unprocessed food) increased only by around 0.5 percentage points on average to reach levels of between –0.3% in Bulgaria and 2.3% in the Czech Republic in February 2017. With this, core inflation remained below headline inflation in most CESEE countries, indicating that wage rises have not yet fed through substantially to the general price level.

In Turkey, inflation came to 9.9% in February 2017. This was the highest reading since April 2012 and reflects a strong increase in price pressures as inflation had amounted to only 7% in November 2016. The weakness of the Turkish lira and rising energy prices are mainly responsible for this development.

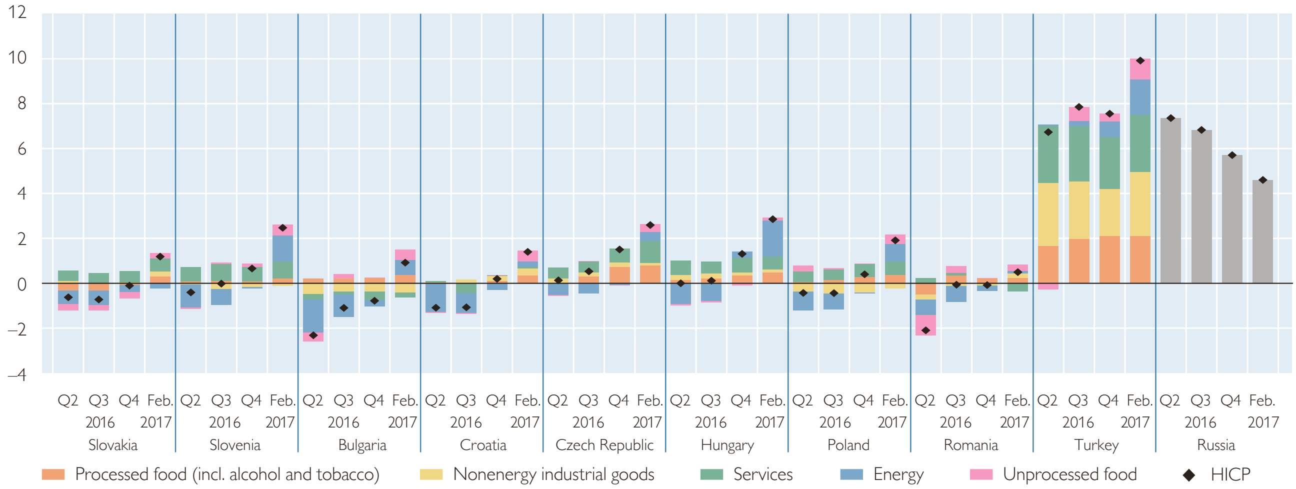
Monetary policy adjustments in Turkey and the Czech Republic

The Czech and Turkish central banks reacted to increasing price pressures in the review period. The Turkish central bank (CBRT) adjusted policy rates upward in an attempt to stabilize the currency. In November 2016, it raised its main policy rate, the one-week repo lending rate, by 50 basis points to 8% and its overnight lending rate by 25 basis points to 8.5%. In January 2017, it increased its overnight lending rate by a further 75 basis points to 9.25%. Furthermore, the late liquidity window lending rate was hiked in two steps by a total of 175 basis points to 11%.

Chart 5

HICP inflation and its main drivers

Percentage points, contribution to year-on-year change in HICP; HICP in %



Source: Eurostat.

Note: Russia: CPI. No breakdown according to COICOP available.

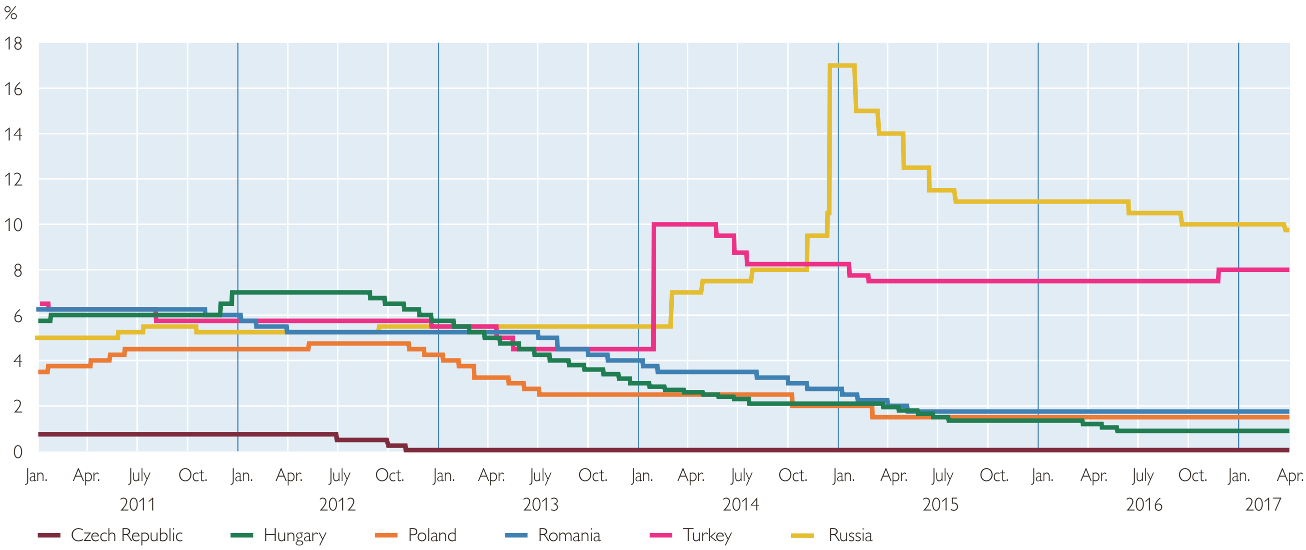
The CBRT also attempted to tighten monetary policy through alternative methods, mainly by shifting its market funding by forcing capital through higher-rate instruments. This led to an increase in the average rate of CBRT funding from around 7.8% in October 2016 to 11.3% in late March 2017.

The Czech National Bank (CNB) officially discontinued the observance of an exchange rate floor against the euro in early April 2017 as inflation reached the 2% target. The floor had been in place since November 2013 to prevent the exchange rate of the Czech koruna from appreciating to levels below CZK 27 per EUR 1. It was installed as an additional instrument to ease monetary conditions after the CNB's policy rate had reached "technically zero." Euro purchases to defend the exchange rate target went up strongly throughout 2016 and peaked at EUR 14.5 billion in January 2017. A further purchase of EUR 8.1 billion in February 2017 brought total CNB interventions to EUR 56 billion. The immediate reaction after the removal of the exchange rate floor was an appreciation of the Czech koruna against the euro by around 1.9% to around CZK 26.5 per EUR 1. In the following days, the Czech koruna depreciated again, reaching a level that was very close to that of the original exchange rate floor. This altogether very moderate reaction of the Czech koruna was not least related to the CNB's commitment to use its instruments to mitigate potential excessive exchange rate fluctuations if needed.

Against the background of moderating inflation, the central bank of Russia (CBR) lowered its policy rate by 25 basis points to 9.75% in March 2017. The CBR stated that disinflation was broadly facilitated by the appreciation of the Russian ruble amid higher-than-expected oil prices, external investors' persistent interest in investing in Russian assets and a drop in the sovereign risk premium.

Chart 6

Policy rate developments in CESEE



Source: National central banks.

Credit growth to finally gain speed throughout CESEE

Growth of domestic credit to the private sector (nominal lending to the non-bank private sector adjusted for exchange rate changes) finally gained speed in the review period, reflecting solid general economic conditions in an environment of low interest rates, monetary accommodation in the euro area and ample global liquidity.

Among the CESEE EU Member States, credit growth was highest in the Czech Republic and Slovakia in February 2017 at 9.1% and 12% in annual terms, respectively. While credit growth remained broadly stable throughout most of 2016, some acceleration was observed in recent months as corporate credit growth gained speed.

Solid credit developments in both countries were supported by the above-mentioned factors but also benefited from their healthy banking sectors: Nonperforming loan (NPL) ratios are low, profitability is sound, credits can be fully funded by local deposits, competitive pressure is high and loans denominated in foreign currency do not play a big role in either country.

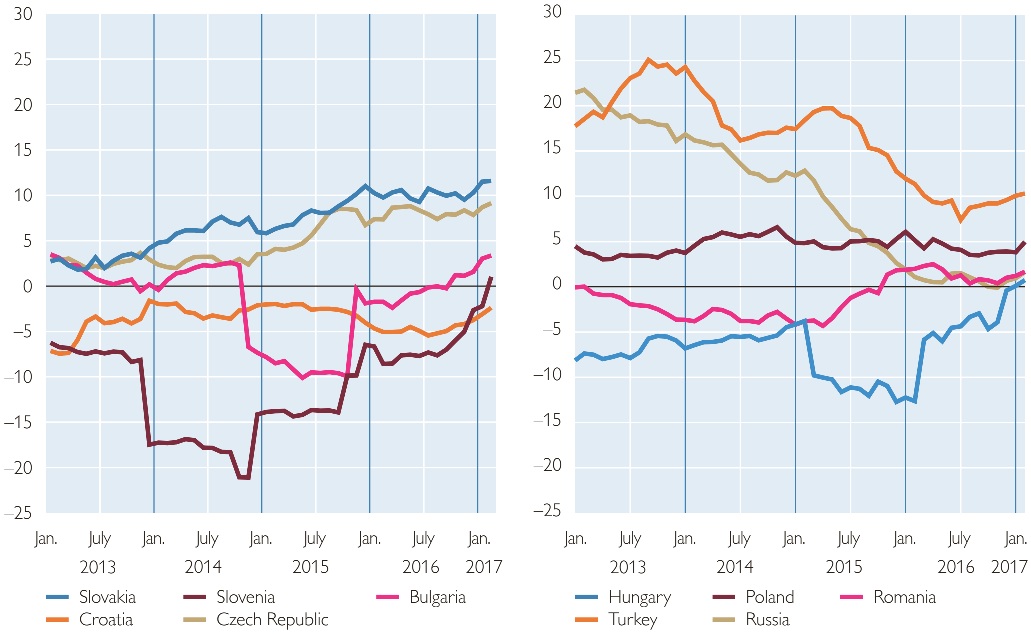
Credit growth was also rather swift in Poland. Nevertheless, credit growth dynamics fell short of those recorded in the Czech Republic and Slovakia. This might in part be related to heightened levels of uncertainty regarding institutional (mainly legal and tax) changes that have been detrimental to investing in Poland. In fact, corporate credit growth decelerated notably throughout 2016. Furthermore, Poland still reports a substantial share of foreign currency loans (especially denominated in Swiss franc) in total loans.

In Romania, credit growth accelerated from a standstill in August 2016 to 1.7% in February 2017. Especially household credit developed robustly, while corporate credit remained a drag on credit growth. Progress has been achieved in shoring up the banking sector in recent years; NPLs have been reduced and the loan-to-deposit ratio has been lowered. Furthermore, banking sector uncertainty declined following court rulings concerning the conversion of Swiss franc loans

Chart 7

Growth of credit to the private sector

Year-on-year percentage change, adjusted for exchange rate changes



Source: National central banks.

and a law allowing retail mortgage borrowers to return real estate collateral to banks in exchange for writing off their loans.

Bulgaria, Slovenia and Hungary reported a turnaround in credit developments: After a prolonged period of decline, credit started to expand again in the review period. Loan developments benefited from robust and broadening GDP growth and a notable decline in nonperforming banking sector assets in all three countries. In Bulgaria, credit dynamics also reflected intensified bank lending in the wake of the completion, in August 2016, of an asset quality review in the banking system. Furthermore, credit expansion was fueled by central bank measures in Hungary (e.g. Funding for Growth Scheme, Growth Supporting Programme). In Slovenia, household credit accelerated while corporate credit continued to decline (at decreasing rates, however). Corporate credit growth was still hampered by low demand from corporates against the background of an increasing use of internal resources and nonbank resources in corporate financing.

Croatia was the only country where the credit stock continued to decrease in the review period. The rate of decrease, however, moderated notably. This development was mainly attributable to some recovery in household credit, reflecting an improvement of the general economic environment and labor market conditions. Furthermore, banking sector trends are promising with NPLs on a clear downward path and banking sector profitability going up. Credit aggregates, however, are still burdened to a certain extent by the impact of the conversion of loans to households indexed to the Swiss franc into euro and a partial write-off of such loans that was completed in mid-2016. In early April, Croatia's constitutional court rejected a request by local banks to assess whether loan conversion was in line with the constitution.

Credit growth in Turkey and Russia reached a trough in mid- and late 2016, respectively, before gaining speed in recent months. Loan growth came to 10.3% in Turkey and 1.6% in Russia in February 2017. In Turkey, this was related to accommodative macroprudential policies, the CBRT's liquidity measures and government incentives. Consumer loans in particular performed strongly. In Russia, the incipient recovery fueled loan demand, especially of households.

Lending surveys indicate a continued strength in demand for credit in the CESEE region. The most recent CESEE Bank Lending Survey of the European Investment Bank (EIB) found that demand for loans improved across the board in the second half of 2016. This marked the seventh consecutive semester of favorable developments. All factors influencing demand made a positive contribution. Working capital and investment accounted for a good part of the strengthening in demand, while debt restructuring started to be less relevant. This is a further indication of an improving and stabilizing macroeconomic and financial environment, which seems to be more conducive to investment. Access to funding also continued to improve in CESEE, supported by easy access to domestic sources (mainly retail and corporate deposits).

Aggregate supply conditions remained basically neutral over the second half of 2016. Across the client spectrum, credit standards eased slightly only for corporates while they tightened on mortgages and remained broadly unchanged for consumer credit. Changes in regulation and banks' capital constraints are perceived as key factors that adversely affect supply conditions. Moreover, the EIB survey also consistently indicates NPLs as a drag on credit supply.

In the period ahead, banks foresee a pickup in expected credit demand and an easing of expected supply conditions. Debt restructuring, working capital, investment, consumer confidence, housing and non-housing-related expenditures are all expected to make a positive contribution to credit demand. Aggregate supply conditions are expected to ease, and the easing is expected to be broader-based than before. However, the gap between credit demand and supply positions seems to be widening further: Optimism on the demand side continues not to be fully met by the development of aggregate conditions on the supply side.

Country-level bank lending surveys conducted by national central banks broadly corroborate these findings: Aggregate demand for credit increased and is expected to do so also in the near future. At the same time, most countries reported some tightening in lending standards at least in certain segments. For example, banks in the Czech Republic tightened their credit standards for loans to households for house purchase and consumer credit as a new consumer credit act entered into effect and the CNB gave recommendations on loan-to-value limits. Furthermore, the Czech Republic was the first EU country to introduce a countercyclical capital buffer of 0.5% of total risk exposure as of January 1, 2017. Slovakia will follow and set into effect a similar buffer of 0.5% in August 2017. In both countries, these decisions were made in response to strong loan growth.

Analyzing the operation of international banking groups in the region, the EIB survey found that 27% of banking groups continued to reduce their total exposure to CESEE, thereby contributing to a further moderate decline of aggregate exposure in the review period. However, this deleveraging trend seems to be bottoming out, as more and more banking groups expect exposure to stabilize over the first half of 2017. While cross-border banking groups continue to discriminate between countries of operation as they reassess their country-by-country strategies, they are also increasingly signaling their intentions to expand operations selectively across the region. The survey also found that roughly two-thirds of banking groups describe the profitability of CESEE operations as outperforming the profitability of the respective banking group as a whole.

Solid economic dynamics support budgetary consolidation

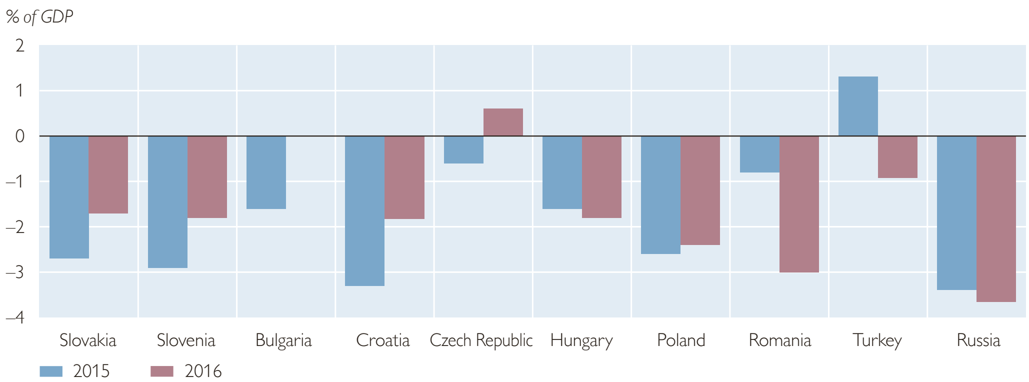
Solid economic dynamics and – in the case of the CESEE EU Member States – lower public investment expenditure amid the slow transition to the new cycle of EU fund programing had a positive impact on the budget balance in most CESEE countries. Deficits decreased most strongly in Croatia and Bulgaria (by 1.5% and 1.6% percentage points of GDP, respectively). In Croatia, deficit reduction was achieved through a combination of windfall revenues stemming from stronger-than-expected economic growth and expenditure restraints facilitated by the presence of caretaker governments with no legislative powers during much of the year. In Bulgaria, tax revenue increases and public investment reductions were the key drivers of fiscal adjustment in 2016, with tax revenues benefiting from improved tax collection among other things. Notable deficit reductions were also achieved in the Czech Republic, Slovakia and Slovenia (by 1.2%, 1.0% and 0.9% percentage points of GDP, respectively).

Higher deficits were reported especially for Romania and Turkey. In Romania, a cut in the standard VAT rate and public wage hikes weighed on the budget. In Turkey, the government significantly stepped up its expenditure in the course of 2016 to offset part of the slump in domestic demand. The further moderate increase in Russia's budget deficit was related to the further decline of the (average) oil price in 2016.

Budget balances ranged from 0% of GDP in Bulgaria to –3.7% of GDP in Russia. The Czech Republic was the only country to report a budget surplus (+0.6% of GDP). No CESEE EU country reported a deficit higher than 3% of GDP. Croatia remains the only country still subject to an excessive deficit procedure (EDP). The target date for a correction of the excessive deficit stands at 2016. Given the improvement in Croatia's general government balance to a deficit of 1.8% of GDP in 2016, the EDP might be abrogated in June 2017.

Chart 8

Development of general government deficits



Source: Eurostat, Europan Commission, wiiw.

Box 1

Western Balkans:[1] resilient growth despite high and rising political risks

Economic recovery continued in the second half of 2016 in the Western Balkan economies with notable accelerations of GDP growth in Albania and Serbia, thus compensating for the GDP slowdown in Montenegro and the former Yugoslav Republic (FYR) of Macedonia. Accordingly, following a prolonged period of sluggish expansion, if any, in recent years, GDP growth in Serbia expanded by 2.8% in 2016 – the highest growth rate since 2008. Similarly, Albanian GDP edged up by 3.2%. In contrast, on the back of increased political uncertainty weighing inter alia on investments, economic growth slowed down markedly to 2.4% in 2016 in FYR Macedonia, while GDP growth declined to 2% on an annual basis in Bosnia and Herzegovina. Also in Montenegro and Kosovo, growth softened somewhat, albeit from a high level, to reach 2.7% and 3.6%, respectively.

In contrast to 2015, the contribution of domestic demand to GDP growth has been robust across all Western Balkan economies (see chart 1). Underpinned by higher employment, robust credit activity but also moderate real wage growth in most of the countries, private consumption accelerated in particular. After several years of consolidation, private consumption benefited from fiscal measures in Serbia. On a negative note, stagnating remittances (especially in Albania, Bosnia and Herzegovina, and Kosovo) were less supportive in 2016 compared with the previous year. On the back of delayed infrastructure projects (e.g. in Bosnia and Herzegovina, and Montenegro), the contribution of investment activity declined but remained positive. Only in FYR Macedonia, investment suffered a strong blow and declined, mirroring prolonged political instability. In contrast, both private and public capital formation along with FDI contributed positively to growth in Serbia and Albania. In Albania, these three factors constituted the primary source of economic growth.

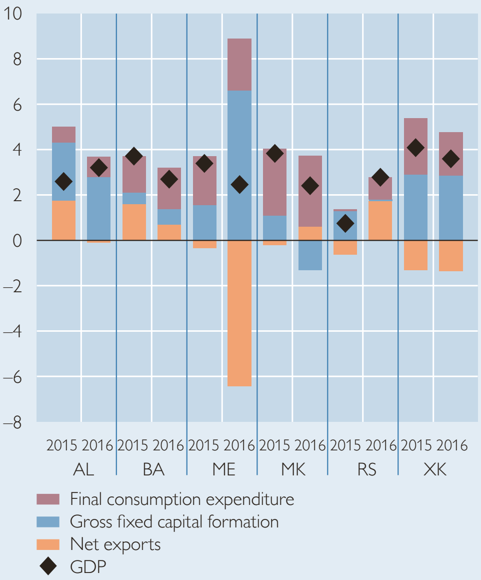
Net exports became less supportive of GDP growth in 2016. A strong and positive contribution was recorded in Serbia and in Bosnia and Herzegovina on the back of the strong dynamics in manufacturing exports. In Serbia, this was partly the result of reforms aimed to broaden the export base. In Albania, the trade deficit widened due to increased investment-related imports (+8.2% year on year) and still subdued commodities exports. Also in Kosovo, commodity exports performed modestly. In contrast, strong construction-related imports dwarfed exports and thus propelled the negative contribution of net exports to growth to the highest levels since 2009 in Montenegro despite an exceptional tourist season.

Labor market conditions in the Western Balkan countries remained strained overall, but the ongoing economic recovery as well as recent reforms in some countries fed through to the decline of unemployment rates. Unemployment (Labour Force Survey methodology) declined in the Western Balkans as of end-2016 despite increased labor participation rates. The declines were strongest in Serbia and Albania (down to 13% and 14%, respectively), thus hitting the lowest levels of the past ten years. Only in Montenegro, unemployment edged up to 18%, which was allegedly attributable to policy measures weighing on female labor force participation. Overall, unemployment reduction went hand in hand with an increase in employment except in Bosnia and Herzegovina, where it stagnated in 2016. The increase was strongest in Serbia and Albania, where the employment rate (measuring employed persons relative to the total population) moved up by 3 percentage points to slightly above 55% – the highest rates in the region but still well below the average euro area employment rate (almost 64%).

[1] *The Western Balkans comprise the EU candidate countries Albania (AL), FYR Macedonia (MK), Montenegro (ME) and Serbia (RS) as well as the potential candidate countries Bosnia and Herzegovina (BA) and Kosovo (XK). The designation "Kosovo" is used without prejudice to positions on status and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.*

Chart 1

GDP growth and its main components in 2016



Source: Eurostat, wiiw, World Bank.

Mirroring exchange rate stability as well as low commodity prices, consumer price inflation in the Western Balkans in the second half of 2016 remained subdued, overall, and even hovered in negative territory in FYR Macedonia (–0.1% year on year) and Bosnia and Herzegovina (–0.8% year on year). On an annual basis, consumer price inflation remained broadly flat at an average of 0.5%. Only in Kosovo, energy and food prices induced a turnaround to an average of 1.3% in the second half of 2016. The acceleration of economic activity fed through to inflation toward the end of 2016 and the first months of 2017, and all countries posted positive inflation rates in February 2017. With inflation climbing to 1.2% in Bosnia and Herzegovina in February 2017, this appears to have ceased the prolonged deflationary trend that had started in mid-2013.

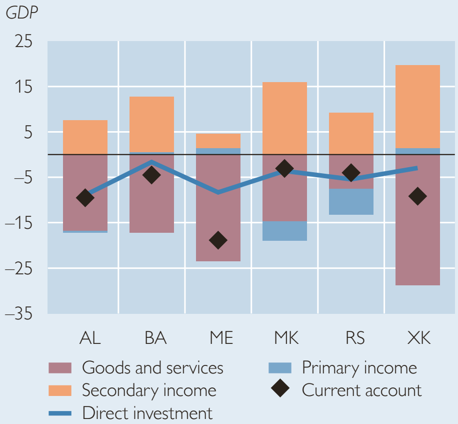
Both inflation-targeting countries – Albania and Serbia – undershot the lower bound of their inflation targets in the second half of 2016. However, prices climbed up in the last quarter of 2016 and in the first two months of 2017. Albania registered an inflation of 2.3% in February, which was above the lower bound of the Bank of Albania's inflation target, which lies at 3% with a tolerance band of ±1 percentage point. In Serbia, inflation accelerated sizeably, reaching 3.2% in February, which for the first time since mid-2014 is within the inflation bound, which has been lowered as from January 2017 to 3% ±1.5 percentage points. The National Bank of Serbia (NBS) has maintained its key policy rate at a historical low of 4% since July 2016, while the Bank of Albania has left its policy rate at 1.25% since May 2016. The central bank of FYR Macedonia lowered its benchmark interest rate between December and February by a cumulative 75 basis points to 3.25%, countering increases implemented in the wake of deposit outflows in 2016. The Albanian lek has remained fairly stable against the euro over the last half year. As for the Serbian dinar, the NBS intervened frequently on the foreign exchange market to reduce exchange rate volatility vis-à-vis the euro, thus limiting the depreciation of the Serbian dinar to close to 1% between October 2016 and March 2017.

On the back of resolution mechanisms put in place in some Western Balkan countries in 2016, bank asset quality gradually improved and supported credit growth although NPL ratios remained well above precrisis levels. In December 2016, Albania and Serbia still recorded the highest NPL ratios in the region at 18.3% and 17%, respectively. At the same time, provisions to write off old NPLs in FYR Macedonia almost halved to 5.5% of total loans on an annual basis. Although an NPL resolution mechanism in still not in place, Kosovo has the lowest NPL share in total loans in the Western Balkans, which even declined to 4.7% at end-2016.

The ongoing process of cleaning up banks' balance sheets, more favorable lending conditions and elevated domestic demand fed through on credit dynamics in most countries although the second half of 2016 was marked by more moderate credit growth. As a common feature among all Western Balkan countries, lending to households has been growing stronger than loans to corporates. Overall, bank lending to the private sector expanded most strongly in Kosovo (10% year on year) and Serbia (5% year on year), while in FYR Macedonia it remained positive but was on a declining path during the last months of 2016 (2.1% year on year). Despite accommodative monetary policy and eased credit standards, lending in Albania was sluggish and still held back by the slow resolution of high NPL stocks.

Chart 2

Current account and direct investment



Source: IMF, national central banks, World Bank.

With respect to the fiscal stance, robust revenue growth supported the narrowing of fiscal imbalances in most of the Western Balkan economies in 2016. On a negative note, the overall underexecution of capital expenditures turned out to be equally supportive of the decline in fiscal deficits. This was particularly relevant for FYR Macedonia, where the deficit declined to 2.6% of GDP, which is significantly below the 4% target announced in the second budget revision. Montenegro posted the highest fiscal deficit in the region in 2016; however, its deficit had still almost halved on an annual basis to 3.9% of GDP, which is well below the target of 7.2% of GDP. On the back of reforms of state-owned enterprises (SOEs) but also due to a rationalization of current spending, the budget deficits of Albania and Serbia declined to 2.2% and 1.4% of GDP, respectively. In line with the country's fiscal rule, the budget deficit edged down to 1.3% of GDP in 2016 in Kosovo, reflecting increases in excise and VAT revenues. The fiscal stance in Bosnia and Herzegovina turned slightly expansionary. The fiscal balance turned negative in 2016 (–0.9% of GDP) and the fiscal situation remains challenging not least because of upcoming elevated refinancing needs and a delay in the payment of a tranche under the current IMF program. On a positive note, for the first time since 2009, favorable fiscal deficit developments but also faster GDP growth helped stabilize public debt or even bring the stock of public debt onto a declining path in 2016 in most of the Western Balkan economies. Accordingly, public debt declined in Albania and Serbia, although still scoring the highest levels in the region (71.6% and 74% of GDP, respectively). In FYR Macedonia, the annual increase in public debt was the most pronounced throughout the region (3.4 percentage points), which was partly attributable to higher state guarantees to SOEs.

Since the first quarter of 2017, four of the Western Balkan countries have participated in programs with the IMF. While Albania successfully completed its 36-month Extended Fund Facility (EFF) program with the IMF in February 2017, the first review under the EFF program with Bosnia and Herzegovina (initially approved in September 2016) was postponed in April 2017 due to delays of agreed reforms, thus withholding a tranche of EUR 80 million. Serbia successfully concluded the sixth review under the precautionary stand-by arrangement (SBA) with the IMF, thus making available (accumulatively) nearly three-quarters of the total sum of EUR 1.2 billion. In Kosovo, the IMF Board completed the combined second and third reviews under the current SBA, enabling a disbursement of around EUR 100 million. At the same time, the program has been extended by nearly three months to the beginning of August 2017 to allow sufficient time for structural reforms to progress.

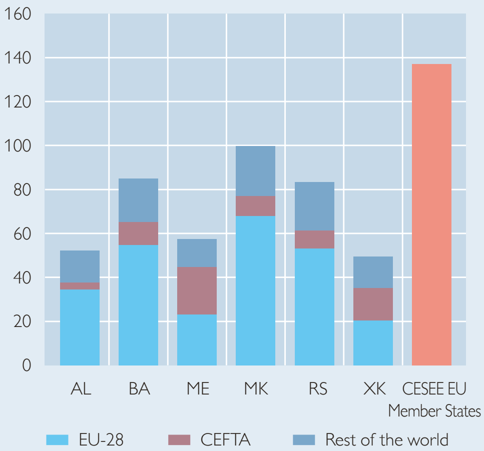
Spotlight: taking stock of external vulnerabilities and trade integration of the Western Balkan countries

External imbalances constitute a major and lasting vulnerability of the Western Balkan economies. On a positive note, in 2016 private sector-oriented reforms and higher external demand, among other things, contributed to the narrowing of external deficits to all-time lows in some countries of the region. The improvement was most sizeable in Albania, Bosnia and Herzegovina, and Serbia (down to 9.6%, 4.5% and 4% of GDP, respectively), driven by a lower trade balance deficit (see chart 2). In contrast, in Montenegro, the country with the highest current account gap in the region, the deficit rose markedly to 19.2% of GDP in 2016 (2015:

13.3% of GDP). FDI remained the main source of external financing in the Western Balkans, but its importance edged down on an annual basis in 2016. Still, at an average of 3.7% of GDP in 2016, FDI coverage of the current account deficit amounted to some 78% on a regional average, with the notable exception of Serbia and FYR Macedonia, where FDI provided full coverage.

Chart 3

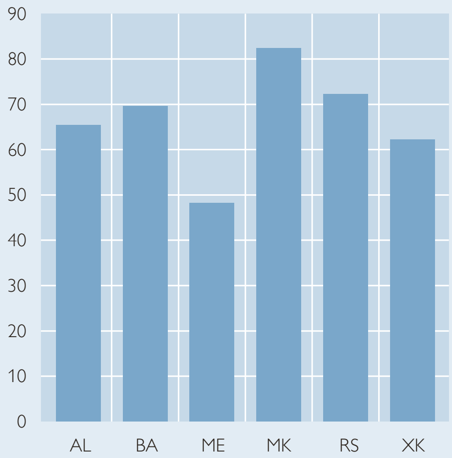
Trade openness in 2015



Source: IMF, NCB, World Bank.

Chart 4

Share of manufacturing in total exports



Source: wiiw.

Overall, all Western Balkan countries show stubbornly high trade deficits, which could be related to the overall narrow export base in the region but which are also explicable by a high dependence on imports for both consumption and investments.[2] *In fact, trade integration within the region but also with the rest of the world is below potential when taking into account the countries' level of development, geographical location and size. The region's trade openness (i.e total imports and exports as a share of GDP) amounted to 71% of GDP in 2015, which is still well below the level of the CESEE EU Member States (see chart 3). The main trading partner of the Western Balkan countries is the EU with shares of up to 70% in total trade (e.g. in FYR Macedonia). At the same time, regional trade remains subdued and, on average, only 12% of total trade is conducted with other CEFTA*[3] *countries (see chart 3).*

In fact, the comparatively low level of trade of the Western Balkan countries is rooted also in the structure of goods traded. Overall, the average share of manufacturing in total exports in the region is well below that in the CESEE EU Member States (see chart 4). It ranges from 48% in Montenegro to close to 90% in FYR Macedonia, with the share being relatively high in FYR Macedonia because of policies that fostered FDI inflows in previous years. As confirmed also by recent EBRD research, the region still lacks sufficient integration into European supply chains. Moreover, the countries are only integrated in the final stages of international supply chains in industries, e. g. the food, beverages and tobacco as well as the textiles and clothing industries.

Finally, as shown by recent results of the World Bank's Doing Business survey, particularly high non-tariff barriers to trade have been pointed out to be a major obstacle to the improvement of trade integration. Thus, key challenges are rooted in the cost and time it takes to export, which are often twice as high in the Wester Balkans than in the CESEE EU Member States.

[2] *A recent European Commission initiative as well as a joint statement by the Western Balkan countries as laid out at a Western Balkan summit in Sarajevo on March 16, 2017, highlighted the pressing need for the Western Balkan economies to foster regional economic integration.*

[3] *The aim of the Central European Free Trade Agreement (CEFTA) is to facilitate trade among the participating countries (as of 2017: Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro, Kosovo, Serbia and Moldavia), eliminate trade barriers, increase investment flows and foster better integration into global supply chains.*

2 Slovakia: EU funding cycle shapes growth composition

Export industry supports solid growth

With real GDP growing at an annual rate of 3%, Slovakia's economy expanded swiftly during the second half of 2016. The expansion was largely the result of exports, which grew by 4.5% and 6.3% year on year in the third and fourth quarters, respectively. By contrast, capital investments dropped sharply (by –17% and –15% year on year, respectively) due to a sluggish start of drawdowns of EU funds in the new programing period. Given the substantial import content of Slovakia's capital investments, this contraction implied a slowdown in import growth, thus contributing to Slovakia's trade surplus. Investments are expected to gain momentum as the funding cycle extends. The capital stock will further benefit from a new automotive plant, the construction of which started in 2016. Cars are expected to boost exports as from 2018.

Private consumption benefits from sustained labor market dynamics

On the back of beneficial labor market and moderate price dynamics, private consumption increased by 2.5% and 3% year on year in the third and fourth quarters, respectively. Slovakia's unemployment rate has been declining for several quarters, reaching 8.6% in February 2017. At the same time, employment growth reached a post-crises record high. As a consequence, the private sector has started to perceive shortages in skilled labor, which are likely to add to recent wage dynamics. These developments contribute to increases in nominal disposable income. The persistently low level of commodity prices fostered real incomes by driving the robust rise of domestic consumption. According to the National Bank of Slovakia, surging labor market demand has started to attract supply from abroad, suggesting that private sector wage growth will maintain its dynamics. The government has been increasing teachers' salaries at an annual rate of 5% between 2012 and 2015, and by 6% in 2016. This fuels wage growth in the public sector and further highlights the importance of private consumption for future real economic activity.

Inflation seems to have bottomed out at last

Inflation remained subdued in the second half of 2016. Given a reduction in administered gas and electricity prices, energy continued to become less expensive, notwithstanding the recent rise in global energy prices. By extending the basket of items qualifying for a reduced VAT rate, the government furthermore contributed to negative food price developments. Food prices had already been under pressure because of high-yielding global grain harvests. The recent decision of the Regulatory Office for Network Industries to lower gas and electricity prices further is expected to drag on overall inflation in the near future. Nevertheless, food prices have started to accelerate recently, bringing inflation to 1.3% in February 2017. At the same time, strong wage growth is becoming visible in an increase in core inflation. This suggests that after three consecutive years of negative price developments, owing to both domestic and global dynamics, inflation is set to finally turn positive.

Private indebtedness is rising

The euro area's low interest rate environment has boosted private indebtedness more in Slovakia than in other comparable countries. Mortgage-backed loans have been increasing at double-digit rates since 2010, and continued to grow by 10% in the second half of 2016. As a result, house prices have picked up considerably (by almost 10% since 2014). To strengthen financial stability, the National Bank of Slovakia has introduced several macroprudential measures since 2014, which have since been progressively tightened. Public debt is still high from a historical perspective but consolidation efforts have reduced its level since 2013. In 2016, the budget deficit decreased to 1.7% of GDP on the back of vivid revenue growth.

Table 2

Main economic indicators: Slovakia

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	2.6	3.8	3.3	3.9	4.6	3.4	3.8	3.0	3.0
Private consumption	1.4	2.2	2.9	2.4	2.4	2.6	3.1	2.5	3.2
Public consumption	5.3	5.4	1.6	6.5	6.0	3.6	2.5	2.1	–1.0
Gross fixed capital formation	1.2	16.9	–9.3	20.7	21.9	1.8	–1.1	–17.0	–15.0
Exports of goods and services	3.7	7.0	4.8	7.2	9.2	0.3	7.8	4.5	6.3
Imports of goods and services	4.4	8.1	2.9	9.8	10.4	0.3	5.9	0.8	4.5
	Contribution to GDP growth in percentage points								
Domestic demand	3.0	4.6	0.9	5.7	5.4	3.4	1.9	–1.1	–0.1
Net exports of goods and services	–0.5	–0.7	1.8	–1.8	–0.8	0.0	1.9	3.2	1.8
Exports of goods and services	3.4	6.4	4.5	6.1	8.5	0.3	7.3	3.8	6.0
Imports of goods and services	–3.9	–7.2	–2.7	–7.9	–9.3	–0.3	–5.4	–0.7	–4.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	0.7	1.2	0.9	1.1	2.0	1.0	–0.1	0.3	2.1
Unit labor costs in manufacturing (nominal, per hour)	1.6	–1.8	2.6	–4.4	–2.5	2.8	–0.4	4.5	3.3
Labor productivity in manufacturing (real, per hour)	2.4	6.3	1.4	8.7	7.8	0.6	3.6	0.2	1.0
Labor costs in manufacturing (nominal, per hour)	4.1	4.5	3.9	3.9	5.1	3.4	3.1	4.7	4.4
Producer price index (PPI) in industry	–3.5	–3.0	–4.0	–2.4	–3.2	–4.2	–5.1	–4.3	–2.3
Consumer price index (here: HICP)	–0.1	–0.3	–0.5	–0.3	–0.5	–0.5	–0.6	–0.7	–0.1
EUR per 1 SKK, + = SKK appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	13.2	11.5	9.7	11.3	11.0	10.4	9.7	9.6	9.2
Employment rate (%, 15–64 years)	61.0	62.7	64.9	63.0	63.5	64.1	64.9	65.1	65.3
Key interest rate per annum (%)	0.2	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0
SKK per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	4.9	11.1	5.4	10.7	11.1	9.3	8.8	8.2	5.4
	Contributions to the year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	4.9	6.2	10.3	10.6	1.8	–2.2	2.9	5.4	7.6
Domestic credit of the banking system	7.9	24.9	26.5	14.2	17.3	13.5	12.4	10.8	8.3
of which: claims on the private sector	10.5	13.2	16.1	6.4	7.8	6.5	5.7	7.2	7.5
claims on households	9.8	11.6	13.1	6.1	5.9	5.8	6.1	6.4	6.5
claims on enterprises	0.7	1.6	3.0	0.3	1.9	0.7	–0.4	0.8	1.0
claims on the public sector (net)	–2.6	11.7	10.4	7.8	9.6	7.0	6.7	3.6	0.8
Other assets (net) of the banking system	–1.7	–14.6	–19.7	–14.1	–8.1	–2.0	–6.6	–7.9	–10.5
	% of GDP								
General government revenues	39.3	42.8	40.0	. .	. .	. .	. .	. .	. .
General government expenditures	42.0	45.6	41.6	. .	. .	. .	. .	. .	. .
General government balance	–2.7	–2.7	–1.7	. .	. .	. .	. .	. .	. .
Primary balance	–0.8	–1.0	0.1	. .	. .	. .	. .	. .	. .
Gross public debt	53.6	52.5	51.9	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	49.7	48.8	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	32.6	35.1	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	3.8	2.3	3.0	0.8	0.8	4.2	4.0	2.2	1.8
Services balance	0.1	0.1	0.5	0.3	–0.4	0.3	0.6	0.7	0.2
Primary income	–2.2	–2.3	–2.6	–3.4	–0.3	–3.6	–2.6	–2.4	–2.0
Secondary income	–1.6	–1.4	–1.6	–1.4	–1.2	–1.7	–1.4	–1.6	–1.8
Current account balance	0.1	–1.3	–0.8	–3.8	–1.1	–0.8	0.6	–1.0	–1.8
Capital account balance	1.0	3.5	2.1	4.0	6.9	3.4	2.4	0.6	2.1
Foreign direct investment (net)	0.2	–1.1	0.4	0.1	–3.5	–1.3	6.0	–2.7	–0.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	88.8	85.6	91.1	86.7	85.6	85.4	87.8	90.0	91.1
Gross official reserves (excluding gold)	1.5	2.1	2.0	2.5	2.1	2.0	2.0	2.0	2.0
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	75,946	78,686	80,958	20,768	20,343	18,524	20,242	21,256	20,936

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

3 Slovenia: output, credit and prices on the rise

Consumption becomes growth driver in 2016

GDP growth in Slovenia held steady during the second half of 2016, resulting in an annual average growth rate of 2.5%. Economic expansion relied heavily on domestic consumption, the growth rate of which strongly picked up in 2016. Private consumption was backed by rising real wages, strong consumer sentiment and the accelerating growth of household credit. Public consumption also grew more strongly than in 2015, which was presumably linked to the gradual lifting of crisis-related fiscal savings measures. The contraction of investment activity gradually moderated in the second half of 2016. The slowdown of EU fund inflows was mirrored in the slump of government investments. Investments in the private sector expanded moderately, in particular in machinery and equipment, reflecting high and rising capacity utilization rates, strong business sentiment and slowly but steadily improving corporate credit growth. Net real exports were roughly neutral for the overall GDP growth rate in 2016, while stock changes added a relatively high 0.8 percentage points to the GDP growth rate. The European Commission's winter forecast expects GDP growth to accelerate to 3% in 2017. Private consumption should remain a major pillar of growth, supported by rising employment and increasing wages, while investments are expected to bounce back and net exports to remain neutral. High-frequency indicators for the beginning of 2017 are a mixed bag, with a further improvement of economic sentiment and accelerating retail sales on the one hand and slowing industrial and construction output on the other.

Fiscal consolidation supported by economic recovery

The general government deficit decreased to 1.8% of GDP in 2016, from 2.9% in 2015. Healthy economic growth, showing in higher-than-expected tax revenues, lower-than-expected subsidies and a large decline in public investments, contributed to the improvement. The European Commission expects the deficit to be cut further to 1.7% of GDP in 2017 (and 1.4% of GDP in 2018), mainly on the back of contained public investments, a reduction in interest expenditure and buoyant tax revenues and notwithstanding a projected moderate rise in public sector wage and pension expenditure. However, the European Commission expects a loosening of the fiscal stance, adjusted for cyclical factors, especially in 2018 and has recently called for structural measures to reduce the structural deficit. According to the European Commission's in-depth review under the 2017 European Semester, Slovenia continues to experience imbalances despite the progress achieved throughout 2016. In particular, further policy action is required with regard to corporate indebtedness and the business environment, remaining weaknesses in the banking sector and long-term fiscal challenges.

Inflation back in positive territory

After an extended period of deflation, year-on-year price changes turned positive again in the final months of 2016. Inflation climbed to 2.5% by February 2017 as prices for energy and unprocessed food went up. Nonbank private sector deleveraging slowed further during the reporting period. The growth of loans to households has accelerated markedly since the third quarter of 2016, while the year-on-year decline in lending to nonfinancial corporations has moderated continuously. However, the improved lending activity failed to translate into an improvement in banks' net interest revenues in 2016 as the decline was steeper in lending than in deposit interest rates. Nevertheless, the reduction in impairment and provisioning costs, which reflected the higher quality of banks' credit portfolio, led to a marked improvement in banks' profitability despite the low interest rate environment in the euro area. Furthermore, banks are well capitalized and have access to sufficient liquidity.

Table 3

Main economic indicators: Slovenia

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	3.1	2.3	2.5	2.0	2.8	2.2	2.7	2.5	2.6
Private consumption	2.0	0.5	2.8	1.1	0.6	1.6	3.5	2.1	4.0
Public consumption	–1.2	2.4	2.6	3.2	3.4	3.9	2.0	1.7	2.8
Gross fixed capital formation	1.4	1.0	–3.1	–0.2	5.4	–7.7	–3.5	–2.5	0.9
Exports of goods and services	5.7	5.6	5.8	5.0	4.3	5.8	7.6	5.4	4.6
Imports of goods and services	4.2	4.6	6.4	5.1	4.7	5.2	8.4	5.9	6.3
	Contribution to GDP growth in percentage points								
Domestic demand	1.7	1.3	2.2	1.6	2.7	1.2	2.5	1.5	3.4
Net exports of goods and services	1.4	1.1	0.1	0.4	0.1	0.9	0.2	0.2	–0.8
Exports of goods and services	4.3	4.2	4.6	3.8	3.4	4.6	5.8	4.2	3.6
Imports of goods and services	–2.9	–3.2	–4.4	–3.4	–3.3	–3.6	–5.6	–4.0	–4.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	–1.3	0.3	1.7	0.2	0.4	2.0	2.5	1.2	1.3
Unit labor costs in manufacturing (nominal, per hour)	–0.1	–5.0	–5.0	–7.8	–3.7	–6.8	–6.5	–5.2	–1.6
Labor productivity in manufacturing (real, per hour)	3.8	5.7	8.7	6.3	4.1	7.8	8.0	8.5	10.6
Labor costs in manufacturing (nominal, per hour)	3.8	0.5	3.3	–2.0	0.2	0.5	1.0	2.8	8.8
Producer price index (PPI) in industry	–0.7	–0.2	–1.4	–0.4	–1.2	–1.9	–2.3	–1.3	–0.1
Consumer price index (here: HICP)	0.4	–0.8	–0.2	–0.8	–0.9	–0.9	–0.4	0.0	0.7
EUR per 1 SIT, + = SIT appreciation	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.9	9.1	8.1	8.7	8.5	9.0	7.9	7.5	8.1
Employment rate (%, 15–64 years)	63.9	65.2	65.9	66.7	65.2	64.2	66.2	66.4	66.6
Key interest rate per annum (%)	0.2	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0
SIT per 1 EUR	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	7.8	5.3	7.2	3.8	5.3	6.3	5.4	6.1	7.2
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	48.9	23.5	0.7	–0.7	–1.6	–6.4	1.5	7.0	2.2
Domestic credit of the banking system	–32.9	–10.7	12.6	3.0	7.8	11.6	3.8	–1.1	4.6
of which: claims on the private sector	–38.4	–20.7	–7.1	–12.4	–4.8	–8.0	–6.7	–5.7	–2.1
claims on households	–2.2	–0.3	1.6	0.0	0.4	0.0	0.3	0.6	1.1
claims on enterprises	–36.2	–20.4	–8.6	–12.4	–5.2	–8.0	–7.0	–6.3	–3.3
claims on the public sector (net)	5.5	10.0	19.6	15.4	12.6	19.6	10.4	4.6	6.7
Other assets (net) of the banking system	–7.9	0.8	–0.4	1.5	–0.9	1.1	0.1	0.1	0.5
	% of GDP								
General government revenues	44.7	45.2	43.6	. .	. .	. .	. .	. .	. .
General government expenditures	50.1	48.1	45.5	. .	. .	. .	. .	. .	. .
General government balance	–5.4	–2.9	–1.8	. .	. .	. .	. .	. .	. .
Primary balance	–2.1	0.4	1.3	. .	. .	. .	. .	. .	. .
Gross public debt	80.9	83.1	79.7	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	79.6	68.2	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	28.5	27.8	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	3.2	3.9	3.9	4.3	3.5	5.1	4.4	3.7	2.4
Services balance	4.5	5.2	5.7	6.1	5.0	5.1	5.4	7.0	5.3
Primary income	–0.3	–2.5	–1.6	–2.9	–2.6	–0.8	–1.6	–2.3	–1.5
Secondary income	–1.1	–1.4	–1.2	–1.1	–1.3	–1.7	–0.9	–1.4	–1.0
Current account balance	6.2	5.2	6.8	6.5	4.7	7.7	7.3	7.1	5.2
Capital account balance	0.4	1.0	–0.8	1.3	1.4	–0.4	–1.1	–0.6	–1.0
Foreign direct investment (net)	–1.6	–3.2	–1.9	–2.2	–6.4	–3.5	–2.6	–2.4	0.8
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	124.0	116.7	109.0	119.2	116.7	116.7	114.3	111.7	109.0
Gross official reserves (excluding gold)	2.0	1.8	1.5	1.9	1.8	1.7	1.7	1.5	1.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	EUR million, period total								
GDP at current prices	37,332	38,570	39,769	9,931	9,831	9,245	10,152	10,197	10,175

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

4 Bulgaria: robust GDP development despite political woes

Higher-than-expected GDP growth in 2016

Economic activity in Bulgaria in 2016 turned out notably stronger than expected, with GDP growth reaching 3.4% year on year. In the second half of 2016, private and public consumption as well as exports contributed positively to economic growth at 2.3%, 4.3% and 7.2% year on year, respectively. However, investments dropped significantly in the second half of 2016 (–7.2%). In October 2016, the Bulgarian National Statistical Institute published significant revisions of GDP data for 2000 to 2016, addressing specific recommendations by Eurostat while taking into account new statistical data. Data for 2015 changed most significantly: GDP growth was revised upward by 0.6 percentage points to 3.6%. Exports accelerated in the second half of 2016, with the main export groups being intermediate and consumption goods. Exports of services also performed well in 2016, growing by 7.3%. With regard to services, Bulgaria's tourism sector profited from geopolitical tensions, especially those in Turkey. However, strong private consumption led to a concurrent increase in imports of goods and services, diminishing the positive effect of exports on the external sector's growth contribution. Private consumption benefited from relatively low unemployment levels (6.7% per year at end-2016), rising wage levels (8.2% in December 2016) and positive consumer sentiment. Investments, by contrast, dropped significantly in the second half of 2016, mainly because of delayed government projects and slower-than-expected EU fund absorption.

Headline inflation turned positive for the first time since August 2013

Headline inflation turned positive in early 2017, amounting to 0.4% in January and 0.9% in February 2017. These were the first positive inflation readings since August 2013. The main driver of this development were energy prices. Inflation in this component accelerated to 6.2% in February 2017. At the same time, core inflation advanced only very moderately and remained negative (–0.3% in February 2017).

NPL ratios decrease and credit growth turns positive again

Private credit growth rates have been positive since October 2016, after a prolonged period of credit stock contraction. In January 2017, loans to households increased by 4.1% and loans to corporates increased by 2.9% year on year. At the same time, the NPL ratio decreased from 10.4% in June 2016 to 9.0% in December 2016. Moreover, the banking sector's after-tax profits soared, going up by 41% year on year and thus boosting return on equity to 10.6%. The main profit drivers were reduced operating expenses (–12.8% year on year) and lower loan loss provisions (–22% year on year). Based on positive loan growth and a reduced NPL ratio, the coverage ratio increased to 75.4% at end-2016. Moreover, the total capital ratio remained stable (22.2% in December 2016).

Third parliamentary elections in four years

Bulgaria reported a balanced budget for 2016, a notable reduction by 1.6 percentage points of GDP compared to 2015. The driving factors behind this development were higher revenues and lower expenditures. While public finance performance was satisfactory, the review period was characterized by rising political uncertainty. Boyko Borisov stepped back as prime minister after the candidate backed by the opposition socialist party, Rumen Radev, won the presidential elections in November 2016. This caused early parliamentary elections, which were held on March 26, 2017. Boyko Borisov and his conservative GERB party received the relative majority of 32.6% of the votes, followed by the socialist party with 26.8%. Before the early parliamentary elections, the caretaker cabinet had held talks with different euro area countries with the intention of applying for participation in the European Exchange Rate Mechanism II (ERM II). These talks had remained without any results, however.

Table 4

Main economic indicators: Bulgaria

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	1.3	3.6	3.4	3.8	3.6	3.6	3.5	3.2	3.5
Private consumption	2.7	4.5	2.1	6.4	7.5	2.5	1.2	1.6	3.0
Public consumption	0.1	1.4	0.6	2.0	3.6	–6.4	–0.6	1.4	7.1
Gross fixed capital formation	3.4	2.7	–4.0	3.4	7.4	1.4	–0.3	–6.9	–7.4
Exports of goods and services	3.1	5.7	5.7	1.9	2.1	3.0	4.6	7.9	6.4
Imports of goods and services	5.2	5.4	2.8	2.5	4.6	0.9	2.8	4.6	2.8
	Contribution to GDP growth in percentage points								
Domestic demand	2.7	3.5	1.6	4.1	5.3	1.9	2.2	0.8	1.6
Net exports of goods and services	–1.3	0.1	1.8	–0.2	–1.7	1.4	1.2	2.6	1.9
Exports of goods and services	2.0	3.7	3.6	1.3	1.2	2.1	3.1	5.3	3.6
Imports of goods and services	–3.4	–3.6	–1.8	–1.6	–2.9	–0.7	–1.8	–2.7	–1.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	4.5	2.3	0.4	0.4	4.1	2.4	1.0	–0.3	–2.0
Unit labor costs in manufacturing (nominal, per hour)	0.4	6.1	8.3	6.4	7.2	8.7	11.5	6.8	6.3
Labor productivity in manufacturing (real, per hour)	6.3	2.1	1.8	2.4	1.7	2.5	–0.9	3.1	2.5
Labor costs in manufacturing (nominal, per hour)	6.8	8.3	10.2	9.0	9.0	11.4	10.6	10.1	9.0
Producer price index (PPI) in industry	–1.2	–2.0	–3.1	–2.4	–4.2	–4.7	–5.2	–3.0	0.6
Consumer price index (here: HICP)	–1.6	–1.1	–1.3	–0.9		–1.1	–2.3	–1.1	–0.8
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	11.5	9.3	7.7	8.3	8.0	8.7	8.2	7.1	6.7
Employment rate (%, 15–64 years)	61.1	62.9	63.4	64.5	63.7	62.3	63.7	64.2	63.4
Key interest rate per annum (%)[1]	. .	. .	. .	. .	. .	. .	. .	. .	. .
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	1.1	8.8	7.6	2.1	8.8	6.1	8.9	8.7	7.6
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	15.7	18.3	21.7	11.3	8.3	11.0	14.1	13.7	12.3
Domestic credit of the banking system	–4.9	–5.7	–1.6	–8.4	1.7	–3.0	–2.5	–2.4	–3.1
of which: claims on the private sector	–6.7	–7.6	0.1	–7.7	–1.2	–1.8	–0.6	–0.1	1.2
claims on households	–0.5	–0.8	0.2	–0.4	–0.4	–0.4	–0.2	0.1	0.5
claims on enterprises	–6.2	–6.8	–0.1	–7.3	–0.9	–1.4	–0.4	–0.2	0.7
claims on the public sector (net)	1.8	1.9	–1.7	–0.7	2.9	–1.2	–2.0	–2.3	–4.3
Other assets (net) of the banking system	–0.6	–2.6	–3.0	–0.8	–1.3	–2.0	–2.7	–2.7	–1.6
	% of GDP								
General government revenues	36.6	39.0	35.5	. .	. .	. .	. .	. .	. .
General government expenditures	42.1	40.7	35.5	. .	. .	. .	. .	. .	. .
General government balance	–5.5	–1.6	0.0	. .	. .	. .	. .	. .	. .
Primary balance	–4.6	–0.8	0.8	. .	. .	. .	. .	. .	. .
Gross public debt	27.0	26.0	29.5	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	108.9	98.3	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	24.9	23.6	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–6.5	–5.8	–3.9	–3.9	–8.0	–3.6	–4.2	–2.5	–5.2
Services balance	5.9	6.6	7.3	13.6	3.1	4.0	6.4	14.7	3.1
Primary income	–3.1	–4.6	–2.5	–3.9	–3.2	–3.3	–2.3	–2.2	–2.5
Secondary income	3.8	3.6	3.3	2.6	1.0	5.1	5.6	1.6	1.8
Current account balance	0.1	–0.1	4.2	8.5	–7.1	2.2	5.5	11.7	–2.8
Capital account balance	2.2	3.1	2.3	2.5	3.1	5.7	2.2	1.4	0.6
Foreign direct investment (net)	–2.1	–5.3	–1.1	–7.4	–1.1	–2.1	–4.3	–1.2	2.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	97.1	81.4	82.2	82.5	81.4	82.6	84.0	82.3	82.2
Gross official reserves (excluding gold)	35.6	42.3	47.5	41.7	42.3	43.5	45.4	46.9	47.5
	Months of imports of goods and services								
Gross official reserves (excluding gold)	6.5	8.1	9.5	7.9	8.1	8.5	9.0	9.3	9.5
	EUR million, period total								
GDP at current prices	42,762	45,287	47,364	12,207	12,605	9,816	11,403	12,954	13,191

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

[1] *Not available in a currency board regime.*

5 Croatia: robust growth on the back of private consumption

Steady increase in private consumption growth; investment growth improved as well

Economic growth again exceeded expectations in the second half of 2016, leading to an overall GDP growth of 2.9% in 2016. GDP growth was mainly fueled by private consumption and investment; public consumption also contributed positively to growth. Private consumption steadily accelerated throughout 2016, which was reflected in a strong increase in consumer optimism and attributable to the overall brighter economic climate, an increase in real disposable income as well as the record tourist season. In addition, unexpected Christmas bonuses in the public sector, where the government had decided on a pay freeze in 2014, boosted private consumption further. 2016 also marked a record growth of gross fixed capital formation at 4.6%. This acceleration had already started in 2015; the temporary deceleration in the third quarter of 2016 was likely to be related to political uncertainty surrounding the dismissal of Prime Minister Tihomir Oreškovic and the end of the coalition government. Net exports also made a positive contribution to growth in the second half of 2016, but for the whole of 2016 the contribution was mildly negative due to strong consumption-driven import growth.

Record tourist season supports current account surplus

The Croatian current account surplus reached 4.8% of GDP in 2015; this rise, however, was partly attributable to the temporary impact of primary income. Although the surplus decreased to 2.6% of GDP in 2016, its major determinants remained largely unchanged. Goods trade in the third quarter was relatively weak but picked up in the fourth quarter of 2016 – improvements were largely attributable to the exports of refined petroleum products. Most importantly, Croatia benefited from a record tourist season. The number of tourist arrivals grew by approximately 9% compared with 2015. Gross external debt declined to 91.4% of GPD on the back of higher-than-expected GDP growth and continued deleveraging by the government and banks.

Expansionary monetary policy continued

Inflation returned to positive territory in the fourth quarter of 2016. This trend has continued in 2017 and is related to increases in world market oil prices and VAT tax changes. The Croatian National Bank (CNB) continued its expansionary stance, and Croatian kuna liquidity in the banking sector was ample. Credit growth remained negative, however. The share of NPLs in total loans declined further, partially because of a more favorable tax treatment of debt write-offs. Results from the OeNB Euro Survey indicate that households' loan demand is recovering, with 6% of households planning to take out a loan in 2017 (the highest percentage since 2009). Despite domestic liquidity, the Croatian kuna appreciated moderately against the euro in 2016. In the second half of 2016, the CNB conducted three foreign exchange interventions, purchasing EUR 785.3 million from banks – the first purchase interventions since 2012, when the CNB purchased EUR 58.1 million.

Budgetary situation improved but some risks remain

The general government balance was negative but much better than expected at –1.8% of GDP, and well below the EDP target of 2.7%. The decline in the deficit is reflected in a drop in gross public debt to 84.1% of GDP. Confirming these favorable developments, Moody's recently changed the rating outlook for Croatia from negative to stable, following earlier upgrades by Standard and Poor's and Fitch. Recent news regarding the government's intention to buy back the stake of Hungary's mineral oil group MOL in the Croatian oil company INA and the debt crisis of Croatia's largest company Agrokor have led to some concerns about whether the government will be able to adhere to its budget plans, which are based on a growth projection of 3.2% for 2017.

Table 5

Main economic indicators: Croatia

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	–0.5	1.6	2.9	2.8	1.8	2.7	2.8	2.8	2.8
Private consumption	–1.6	1.2	3.3	1.5	2.6	3.1	3.0	3.3	3.6
Public consumption	–0.8	–0.3	1.7	–0.2	–0.3	0.4	2.5	2.1	1.8
Gross fixed capital formation	–2.8	1.6	4.6	2.5	3.4	4.3	6.5	2.9	4.6
Exports of goods and services	7.6	10.0	6.7	7.9	10.9	7.2	4.0	6.3	9.7
Imports of goods and services	4.5	9.4	7.3	8.0	13.9	6.1	7.3	6.0	9.7
	Contribution to GDP growth in percentage points								
Domestic demand	–1.9	1.2	3.0	1.2	3.3	2.7	4.4	1.5	3.7
Net exports of goods and services	1.4	0.5	–0.1	1.6	–1.5	–0.1	–1.7	1.5	–0.3
Exports of goods and services	3.3	4.7	3.3	5.1	4.6	2.8	1.8	4.2	4.4
Imports of goods and services	–1.9	–4.2	–3.4	–3.4	–6.0	–2.9	–3.6	–2.7	–4.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit labor costs in manufacturing (nominal, per hour)	–5.3	–3.9	32.6	–6.2	–6.2	27.6	30.3	40.1	33.3
Labor productivity in manufacturing (real, per hour)	5.4	6.3	–31.3	8.2	8.0	–26.4	–33.3	–34.3	–30.5
Labor costs in manufacturing (nominal, per hour)	–0.3	2.0	–8.7	1.4	1.3	–6.2	–13.1	–8.0	–7.3
Producer price index (PPI) in industry	–2.7	–3.9	–4.3	–4.1	–4.2	–4.7	–6.1	–4.6	–1.7
Consumer price index (here: CPI)	0.2	–0.3	–0.6	–0.3	–0.4	–0.5	–1.1	–1.1	0.2
EUR per 1 HRK, + = HRK appreciation	–0.7	0.3	1.1	0.6	0.6	0.8	0.9	1.1	1.3
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	17.5	16.4	13.3	15.6	16.3	15.6	13.0	11.0	13.5
Employment rate (%, 15–64 years)	54.6	56.0	56.9	57.5	55.8	55.0	57.4	58.4	56.8
Key interest rate per annum (%)	. .	. .	. .	. .	. .	. .	. .	. .	. .
HRK per 1 EUR	7.6	7.6	7.5	7.6	7.6	7.6	7.5	7.5	7.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	3.2	5.1	4.7	4.6	5.1	3.4	4.6	4.3	4.7
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	10.9	11.5	10.8	4.7	6.5	3.7	5.9	5.4	4.1
Domestic credit of the banking system	–1.8	–0.2	–0.6	1.8	–0.3	–2.4	–2.6	–2.7	–0.4
of which: claims on the private sector	–2.5	–4.1	–5.5	–1.5	–2.4	–5.2	–4.8	–4.1	–2.9
claims on households	–1.3	–1.1	–3.2	–0.3	–0.7	–3.8	–3.4	–3.0	–2.4
claims on enterprises	–1.2	–3.0	–2.2	–1.2	–1.7	–1.4	–1.4	–1.1	–0.5
claims on the public sector (net)	0.7	3.9	4.8	3.3	2.2	2.8	2.2	1.3	2.5
Other assets (net) of the banking system	–1.8	–2.8	–0.1	–1.9	–1.1	2.1	1.3	1.6	1.0
	% of GDP								
General government revenues	42.9	43.6	44.3	. .	. .	. .	. .	. .	. .
General government expenditures	48.3	46.9	46.1	. .	. .	. .	. .	. .	. .
General government balance	–5.4	–3.3	–1.8	. .	. .	. .	. .	. .	. .
Primary balance	–1.9	0.3	1.6	. .	. .	. .	. .	. .	. .
Gross public debt	86.6	86.7	84.1	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	101.2	100.8	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	40.3	39.0	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–15.2	–15.9	–16.1	–14.8	–14.0	–17.4	–18.3	–15.3	–13.6
Services balance	17.1	18.4	19.2	41.7	6.2	3.7	18.4	44.2	6.3
Primary income	–2.0	–0.6	–3.4	2.8	0.0	–3.6	–3.4	–4.7	–2.0
Secondary income	2.1	2.9	2.9	2.3	3.6	1.6	4.2	2.4	3.2
Current account balance	2.1	4.8	2.6	32.0	–4.2	–15.6	0.9	26.6	–6.1
Capital account balance	0.2	0.7	1.1	0.5	1.3	0.6	1.2	1.0	1.7
Foreign direct investment (net)	–1.6	–0.6	–4.3	0.5	–0.2	–4.9	–2.5	–5.8	–3.9
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	108.0	103.5	91.4	107.4	103.5	100.2	97.5	94.2	91.4
Gross official reserves (excluding gold)	29.5	31.3	29.7	30.8	31.3	29.9	29.0	28.9	29.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	8.1	8.1	7.6	8.1	8.1	7.7	7.5	7.4	7.6
	EUR million, period total								
GDP at current prices	42,982	43,861	45,571	12,120	10,957	10,156	11,332	12,614	11,469

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

6 Czech Republic: exports and private consumption remain key drivers of growth

Private consumption supports growth amid sluggish investment dynamics

The Czech Republic remained on a solid growth trajectory in the second half of 2016. Real GDP expanded more modestly when contrasted with the first half of the year, largely owing to a contraction in gross fixed capital investments, which are expected to regain momentum soon as disbursements from EU funds should increase and as capacity utilization remains high at around 85%. However, the subdued volume of public investments and higher-than-expected tax revenues, partly related to the introduction of an electronic sales registration, filled public coffers. The headline balance reached a surplus of 0.6% of GDP in 2016.

With growth rates of around 3% year on year in the third and fourth quarters, respectively, private consumption confirmed its stance as a key driver of economic activity. The expansion was fueled by various factors including positive consumer sentiment, accommodative monetary policies and a tightening labor market. Unemployment in the Czech Republic stands at a record low while the employment rate reached historical highs at end-2016. According to the latest business survey of the Czech statistical office, labor shortages are increasingly perceived to become a barrier to growth. Even if employment growth should have reached a climax, employees' bargaining power remains strong. Wage increases are thus increasingly expected to compensate for a potential slowdown in employment dynamics, with positive implications for households' disposable incomes. In the light of sluggish public consumption growth and declining capital investments, the formidable growth contribution of domestic demand (around 1 percentage point in the third and fourth quarters) is all the more surprising.

International trade contributed to overall growth in the second half of 2016, albeit to a lesser extent than in the first. While weaker external demand, primarily for products of the automotive industry, drove down export growth, imports grew even less strongly, owing to the sharp decline in investment spending, which is typically characterized by a high import content. As a consequence, net exports had a positive impact on GDP growth, contributing 1.1 percentage points to overall growth in 2016. Subdued commodity prices contributed to a solid surplus in the trade and services balance. A decrease in the primary income deficit further fostered the current account surplus. However, as commodity prices are slowly recovering and the Czech koruna has started to appreciate, the current account surplus is likely to decrease again.

Price dynamics are above target

Constrained by a zero lower bound, the Czech National Bank (CNB) introduced an exchange rate floor at 27 CZK per EUR in November 2013 to counter deflationary tendencies. In the second half of 2016, consumer prices eventually started to recover rapidly across Europe. The tightening labor market, recovering food prices and the introduction of electronic sales registration were the main drivers behind these dynamics in the Czech Republic. As the latest CPI indicator suggested that inflation was already above the 2% target at the beginning of 2017, the CNB removed the exchange rate floor soon after its "hard commitment" ended on March 31, 2017. As expected, the Czech koruna appreciated modestly (to around 26.5 CZK per EUR) on the same day. However, in the following days the Czech koruna again lost some value and traded at levels close to those of the original exchange rate floor. This was helped by the CNB's commitment to intervene in the foreign exchange market, also after the removal of the exchange rate floor, to mitigate exuberant fluctuations of the Czech koruna.

Table 6

Main economic indicators: Czech Republic

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	2.7	4.5	2.4	4.2	4.3	2.7	3.6	1.6	2.0
Private consumption	1.8	3.0	2.9	2.4	2.9	2.5	3.1	2.9	3.0
Public consumption	1.1	2.0	1.2	3.3	1.9	1.5	2.4	0.9	0.2
Gross fixed capital formation	3.9	9.0	–3.7	10.1	9.5	–0.9	–4.1	–4.3	–5.0
Exports of goods and services	8.7	7.7	4.3	6.3	9.3	5.5	8.4	1.5	1.8
Imports of goods and services	10.1	8.2	3.2	6.8	8.4	5.3	6.4	0.9	0.5
	Contribution to GDP growth in percentage points								
Domestic demand	3.2	4.4	1.4	4.3	3.3	2.1	1.6	1.0	0.8
Net exports of goods and services	–0.5	0.1	1.1	0.0	1.1	0.7	2.0	0.5	1.1
Exports of goods and services	6.6	6.4	3.5	5.0	7.6	4.8	6.9	1.2	1.5
Imports of goods and services	–7.1	–6.3	–2.5	–5.0	–6.5	–4.2	–4.9	–0.7	–0.4
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	0.4	–0.5	3.2	–0.3	0.0	2.6	1.6	4.6	4.2
Unit labor costs in manufacturing (nominal, per hour)	–1.3	–1.2	1.2	–6.4	7.3	–3.3	3.3	8.2	–2.7
Labor productivity in manufacturing (real, per hour)	4.9	4.2	1.9	5.1	2.3	3.0	1.0	1.3	2.3
Labor costs in manufacturing (nominal, per hour)	3.6	3.1	3.2	–1.6	9.7	–0.4	4.3	9.6	–0.5
Producer price index (PPI) in industry	1.0	–2.5	–3.2	–3.1	–3.4	–4.0	–4.5	–3.0	–1.3
Consumer price index (here: HICP)	0.4	0.3	0.6	0.3	0.0	0.4	0.1	0.5	1.5
EUR per 1 CZK, + = CZK appreciation	–5.6	0.9	0.9	2.0	2.1	2.2	1.3	0.2	0.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	6.2	5.1	4.0	4.9	4.5	4.4	4.0	4.0	3.6
Employment rate (%, 15–64 years)	69.0	70.2	72.0	70.5	70.8	71.0	71.7	72.2	72.9
Key interest rate per annum (%)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
CZK per 1 EUR	27.5	27.3	27.0	27.1	27.1	27.0	27.0	27.0	27.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	5.9	8.0	6.5	8.8	8.0	9.4	9.5	8.4	6.5
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	5.8	7.2	14.8	3.5	6.7	6.4	8.0	8.1	7.5
Domestic credit of the banking system	12.1	10.2	2.7	5.5	2.0	1.7	1.1	1.2	0.7
of which: claims on the private sector	5.8	7.7	10.2	6.3	4.6	5.8	5.6	5.3	5.2
claims on households	2.5	4.0	5.7	2.2	2.8	2.8	2.4	2.6	2.7
claims on enterprises	3.3	3.7	4.5	4.1	1.8	3.0	3.2	2.7	2.6
claims on the public sector (net)	6.3	2.5	–7.5	–0.8	–2.6	–4.2	–4.5	–4.1	–4.6
Other assets (net) of the banking system	–5.7	–3.1	–2.5	–0.2	–0.8	1.4	0.4	–0.9	–1.6
	% of GDP								
General government revenues	40.3	41.4	40.5	. .	. .	. .	. .	. .	. .
General government expenditures	42.2	42.1	39.9	. .	. .	. .	. .	. .	. .
General government balance	–1.9	–0.6	0.6	. .	. .	. .	. .	. .	. .
Primary balance	–0.6	0.4	1.5	. .	. .	. .	. .	. .	. .
Gross public debt	42.2	40.3	37.2	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	64.0	59.2	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	30.1	30.7	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	5.1	4.6	5.3	3.3	3.2	7.6	6.8	3.8	3.2
Services balance	1.3	1.6	2.1	1.7	1.5	2.2	2.1	2.3	2.0
Primary income	–6.0	–5.4	–5.8	–7.9	–2.6	–0.5	–8.9	–7.3	–5.9
Secondary income	–0.2	0.0	–0.6	–0.2	–0.9	0.6	–1.0	–0.7	–1.1
Current account balance	0.2	0.9	1.1	–3.1	1.2	10.0	–1.0	–1.9	–1.9
Capital account balance	0.7	2.3	1.1	0.7	1.2	1.7	1.8	1.0	0.1
Foreign direct investment (net)	–1.9	0.6	–3.0	1.2	1.8	0.9	–7.0	–4.3	–1.2
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	69.6	70.8	74.9	73.2	70.8	70.5	71.2	72.4	74.9
Gross official reserves (excluding gold)	28.4	35.3	46.4	34.1	35.3	37.8	39.0	42.2	46.4
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.5	5.5	7.7	5.3	5.5	6.0	6.3	6.9	7.7
	EUR million, period total								
GDP at current prices	156,641	167,003	174,412	42,938	44,212	40,472	44,205	44,229	45,506

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

7 Hungary: GDP to accelerate in 2017 after slowdown in 2016

GDP growth slows to 2% in 2016

Hungarian GDP growth gradually slowed down during the second half of 2016 to 1.6% year on year in the fourth quarter. The growth pattern observed in the second half of 2016 was very similar to that of the first half. Private consumption remained the major growth engine, fueled by strong real wage growth, employment gains (leading even to labor shortages in some economic sectors), record-high consumer confidence and less negative credit developments. GDP growth was also supported by inventory rebuilding during the second half of 2016, contrasting the sharp destocking in the previous few years. By contrast, public consumption growth turned negative during the second half-year, which was also mirrored in very favorable budgetary developments until November 2016. Gross fixed capital formation saw a large contraction again in the second half of 2016 as EU fund inflows are yet to kick in. Both export and import dynamics slowed in the second half-year, with net exports contributing modestly to the overall GDP growth rate. Economic growth is expected to accelerate in 2017 and high-frequency indicators for the beginning of 2017, such as industrial output, construction or exports, already signal a strengthening.

Fiscal policy turning expansive

Following heavy government spending in the final month of 2016 aimed to consume the budgetary room created by fiscal developments earlier in the year, the general government deficit reached 1.8% of GDP in 2016, up from 1.6% of GDP in 2015, but still below the official deficit target of 2% of GDP. According to the European Commission, the deficit is set to rise further to 2.4% of GDP in 2017 (and 2.5% of GDP in 2018) owing to various tax cuts and expenditure-increasing measures. Adjusted for changes in the output gap, the fiscal loosening estimated by the European Commission could be even larger than in the case of the headline deficit (this would mean that the structural deficit would be up from 2.2% of GDP in 2016 to 3.4% of GDP in 2017 and 3.6% of GDP in 2018, i.e. it would be moving away from the country's medium-term objective of 1.5% of GDP). According to a recent assessment by the European Commission, the deterioration in the structural balance, in the absence of a subsequent correction, may jeopardize the goal of a steady reduction in public debt over the medium term.

Loose monetary conditions and economic recovery support lending and rekindle inflation

Over the review period, the Hungarian central bank (MNB) continued to gradually loosen monetary conditions by reducing the accepted volume in its main deposit facility for banks while keeping its key interest rates unchanged. Supported by the low interest rate environment and the MNB's lending supporting schemes for SMEs, lending to the corporate sector picked up gradually as from mid-2016, and by December 2016 the corporate credit stock had expanded (in year-on-year terms) for the first time in two years. There are also signs that the contraction in lending to households may have reached the bottom toward end-2016 and it is expected to pick up in 2017, in part because of the government's expanded housing subsidy program and rising house prices. Banking sector profitability improved substantially in 2016, supported by lower provisioning costs and the bank tax reduction. Banks are adequately capitalized and maintain a solid funding structure, while NPLs continued to decline and are well provisioned. Meanwhile, inflation has gradually accelerated since mid-2016, reaching 2.9% by February 2017 and thus coming close to the MNB's 3% medium-term target (with a ±1 percentage point tolerance band). The rise in inflation was attributable to energy and processed food (including alcohol and tobacco) prices. In its February 2017 inflation report, the MNB expected inflation to fall back in spring 2017, before starting to rise again to reach the inflation target during the first half of 2018.

Table 7

Main economic indicators: Hungary

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	4.0	3.1	2.0	2.6	3.4	1.1	2.8	2.2	1.6
Private consumption	2.5	3.4	5.0	3.1	3.8	4.8	5.2	4.6	5.2
Public consumption	4.5	1.0	0.1	2.6	3.4	1.3	4.8	–1.2	–3.9
Gross fixed capital formation	9.9	1.9	–15.5	–1.5	6.4	–10.2	–19.3	–9.9	–19.6
Exports of goods and services	9.8	7.7	5.8	6.6	8.8	4.6	10.3	5.2	3.1
Imports of goods and services	10.9	6.1	5.7	6.3	7.3	7.4	7.9	5.1	2.7
	Contribution to GDP growth in percentage points								
Domestic demand	4.2	1.3	1.4	1.8	1.7	3.0	0.0	1.7	1.0
Net exports of goods and services	–0.2	1.8	0.6	0.8	1.7	–1.9	2.8	0.6	0.6
Exports of goods and services	8.4	6.8	5.2	5.8	7.5	4.4	9.4	4.7	2.7
Imports of goods and services	–8.6	–5.0	–4.7	–5.0	–5.9	–6.3	–6.5	–4.1	–2.2
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	2.0	0.6	5.6	0.4	0.9	7.5	4.0	6.2	4.6
Unit labor costs in manufacturing (nominal, per hour)	–2.5	–0.1	8.5	–0.2	–0.4	8.6	6.6	10.5	8.4
Labor productivity in manufacturing (real, per hour)	5.9	4.1	–2.7	4.2	4.8	–3.2	–1.9	–3.7	–2.0
Labor costs in manufacturing (nominal, per hour)	3.4	4.0	5.6	4.0	4.3	5.1	4.6	6.4	6.2
Producer price index (PPI) in industry	–0.4	–0.9	–1.6	–0.6	–1.1	–1.5	–2.0	–2.5	–0.3
Consumer price index (here: HICP)	0.0	0.1	0.4	0.2	0.6	0.4	0.0	0.1	1.3
EUR per 1 HUF, + = HUF appreciation	–3.8	–0.4	–0.5	0.1	–1.3	–1.0	–2.4	0.3	1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.8	6.9	5.2	6.5	6.2	6.1	5.1	4.9	4.5
Employment rate (%, 15–64 years)	61.8	64.0	66.5	64.8	64.8	65.1	66.4	67.1	67.5
Key interest rate per annum (%)	2.4	1.6	1.0	1.4	1.4	1.3	1.0	0.9	0.9
HUF per 1 EUR	308.7	309.9	311.5	312.1	312.6	312.1	313.3	311.1	309.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	5.1	6.3	6.9	4.1	6.3	5.0	5.4	4.2	6.9
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	14.5	8.9	5.0	–0.3	1.4	–1.2	–0.6	1.3	3.4
Domestic credit of the banking system	0.6	2.3	3.7	2.4	1.8	6.4	4.5	0.6	1.8
of which: claims on the private sector	–4.9	–8.1	–7.3	–6.1	–7.4	–3.3	–2.8	–2.0	0.1
claims on households	–3.0	–5.3	–5.3	–4.1	–4.4	–2.2	–2.0	–1.4	–0.8
claims on enterprises	–1.9	–2.8	–1.6	–2.0	–3.0	–0.9	–0.6	–0.4	1.2
claims on the public sector (net)	5.5	10.4	11.0	8.5	9.2	9.8	7.4	2.7	1.7
Other assets (net) of the banking system	–4.2	0.5	4.9	2.0	3.1	–0.2	1.4	2.3	1.7
	% of GDP								
General government revenues	46.9	48.5	45.6	..	..	..	..	..	..
General government expenditures	49.0	50.0	47.5	..	..	..	..	..	..
General government balance	–2.1	–1.6	–1.8	..	..	..	..	..	..
Primary balance	1.9	2.0	1.3	..	..	..	..	..	..
Gross public debt	75.7	74.7	74.1	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	80.4	76.1	..	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	25.1	21.1	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Trade balance	2.3	4.0	4.7	2.8	4.7	6.1	5.8	3.7	3.5
Services balance	4.7	4.9	5.6	6.5	2.9	4.9	6.4	6.8	4.5
Primary income	–4.2	–4.7	–3.9	–4.9	–5.6	–3.1	–4.3	–4.0	–4.2
Secondary income	–0.7	–0.8	–1.5	–0.8	–0.3	–1.7	–1.4	–1.2	–1.5
Current account balance	2.1	3.4	4.9	3.7	1.7	6.2	6.4	5.3	2.2
Capital account balance	3.8	4.7	0.5	2.6	7.7	1.0	0.6	0.4	0.2
Foreign direct investment (net)	–2.8		–2.8	–4.5	–2.4	–2.3	0.8	–5.5	–4.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	114.9	107.5	96.1	109.3	107.5	105.1	104.7	98.6	96.1
Gross official reserves (excluding gold)	32.9	27.6	21.7	29.6	27.6	25.0	22.3	21.1	21.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	4.8	4.0	3.2	4.3	4.0	3.6	3.2	3.1	3.2
	EUR million, period total								
GDP at current prices	104,959	109,657	112,429	28,032	30,054	24,631	27,825	28,922	31,051

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

8 Poland: strong export growth and accelerating consumption growth

Continued risk of compulsory foreign currency loan conversion

GDP growth moderated to 2.8% in 2016, but accelerated in the fourth quarter. Total final demand growth remained at 4.6% as real exports rose by 8.4% and domestic demand by 2.8%, causing real imports to grow by 8.7%. Foreign demand contributed substantially more to GDP growth than domestic demand, while the net export contribution was close to zero. In 2016, the goods and services surplus increased to 3.7% of GDP and the current account deficit decreased to 0.3%, while the capital account surplus shrank by more than one-half to 1.1% of GDP owing to lower EU transfers. The main reason for the growth slowdown was the slump in fixed investment, caused by initially lower EU fund absorption under the new EU budget and affecting mainly public sector investment and enterprises owned by general government units. The strong inventory buildup could only partially offset this slack in fixed investment. Conditions for business investment remained supportive, given strong foreign demand, contained unit labor cost increases (with better figures in manufacturing for the final quarter of 2016 than for the annual average), stable profitability, a strong liquidity position, stable industrial confidence and rising export orders. Housing investment growth moderated, given a weaker investment focus of specific subsidies for the young. Real wage sum growth declined moderately to 5% due to weaker employment growth and smaller deflation, while real pension growth slowed more bitingly to only 2% and the income of many self-employed persons appears to have advanced by not more than this figure. Thus, private consumption expanded by less than the real wage sum did, although consumer confidence continued to improve. However, its growth accelerated in the second half of 2016, possibly reflecting disappearing deflation expectations and the lagged effect of higher child benefits. Currently, the Sejm discusses a draft law amending the civil code that rekindles the risk of a compulsory conversion (at historic exchange rates) of foreign currency loans to households with adverse financial stability implications.

Core inflation returned to positive territory

In manufacturing, labor costs continued to increase to around 4%, while labor productivity growth declined. The increase in unit labor costs was about 2 percentage points above the euro area average. However, the Polish zloty's euro value was about 4 percentage points lower than a year earlier. In the first quarter of 2017, the Polish zloty regained what it had lost in the fourth quarter. In February, annual headline inflation was positive (1.9% as measured by the HICP), while core inflation stood at 0.9%, with deflation in industrial goods and inflation in processed food and services. The Polish Monetary Policy Council (MPC) has been on hold since March 2015, as inflation stood below its target. The MPC expected inflation to stabilize at a moderate level, with only a gradual rise in inflationary pressure from improving domestic economic conditions.

Fiscal deficit expected to rise in 2017 by more than it declined in 2016

The gross general government deficit came to 2.4% of GDP in 2016 and was thus below the target of 2.6% of GDP envisaged in the government's Convergence Programme and below the deficit level observed in 2015 (2.6% of GDP), owing to a lower expenditure-to-GDP ratio. For 2017, the European Commission expects the headline deficit to rise to 2.9% of GDP and the structural deficit to rise to 3.1% of GDP from 2.6% of GDP in 2016 and 2.4% of GDP in 2015. General government gross debt is forecast to reach 54.5% of GDP at end-2017, after 51.1% of GDP at end-2015.

Table 8

Main economic indicators: Poland

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	3.3	3.9	2.8	3.6	4.6	2.8	3.1	2.0	3.3
Private consumption	2.4	3.2	3.6	2.9	2.3	2.8	2.6	4.7	4.3
Public consumption	4.1	2.3	3.8	–0.5	7.4	4.5	3.0	4.4	3.5
Gross fixed capital formation	10.0	6.1	–5.5	5.5	4.5	–2.4	–4.8	–8.3	–5.5
Exports of goods and services	6.7	7.7	8.4	6.2	9.1	6.8	13.4	5.6	7.9
Imports of goods and services	10.0	6.6	8.7	4.9	7.7	8.6	11.2	8.4	7.0
	Contribution to GDP growth in percentage points								
Domestic demand	4.6	3.3	2.7	2.9	4.0	3.3	1.7	3.2	2.8
Net exports of goods and services	–1.3	0.6	0.1	0.7	0.7	–0.6	1.5	–1.2	0.6
Exports of goods and services	3.1	3.7	4.1	3.1	4.1	3.5	6.7	2.8	3.7
Imports of goods and services	–4.4	–3.0	–4.1	–2.4	–3.3	–4.1	–5.2	–4.0	–3.1
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	0.6	–1.2	..	–0.8	–1.1	–0.2	0.0	–0.1	..
Unit labor costs in manufacturing (nominal, per hour)	2.0	1.1	3.0	2.0	0.5	3.4	2.6	4.1	2.0
Labor productivity in manufacturing (real, per hour)	2.5	2.8	1.0	2.7	1.5	0.2	0.5	–0.6	4.0
Labor costs in manufacturing (nominal, per hour)	4.7	3.9	4.1	4.8	2.1	3.6	3.1	3.5	6.2
Producer price index (PPI) in industry	–1.3	–2.1	–0.3	–2.3	–1.6	–1.5	–1.0	–0.2	1.6
Consumer price index (here: HICP)	0.1	–0.7	–0.2	–0.5	–0.5	–0.3	–0.4	–0.4	0.4
EUR per 1 PLN, + = PLN appreciation	0.3	0.0	–4.1	–0.3	–1.2	–4.0	–6.5	–3.5	–2.6
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	9.1	7.6	6.3	7.1	7.0	7.1	6.3	6.0	5.6
Employment rate (%, 15–64 years)	61.7	62.9	64.5	63.5	63.7	63.7	64.3	64.9	65.1
Key interest rate per annum (%)	2.4	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
PLN per 1 EUR	4.2	4.2	4.4	4.2	4.3	4.4	4.4	4.3	4.4
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.2	9.1	9.6	8.3	9.1	9.1	11.4	9.4	9.6
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	0.4	4.5	5.8	1.8	1.3	–1.1	4.3	2.7	4.1
Domestic credit of the banking system	18.2	20.1	19.4	8.1	9.9	11.5	10.8	8.7	8.7
of which: claims on the private sector	11.5	14.3	11.6	7.4	6.8	4.6	4.9	3.9	4.4
claims on households	6.1	7.2	6.9	3.6	3.7	2.5	2.7	2.8	2.9
claims on enterprises	5.4	7.0	4.8	3.8	3.1	2.1	2.2	1.1	1.6
claims on the public sector (net)	6.7	5.9	7.7	0.7	3.0	6.9	6.0	4.8	4.3
Other assets (net) of the banking system	–3.6	–6.7	–5.6	–1.6	–2.1	–1.3	–3.7	–2.0	–3.2
	% of GDP								
General government revenues	38.8	39.0	38.8	..	..	..	..	..	..
General government expenditures	42.3	41.6	41.3	..	..	..	..	..	..
General government balance	–3.5	–2.6	–2.4	..	..	..	..	..	..
Primary balance	–1.6	–0.8	–0.8	..	..	..	..	..	..
Gross public debt	50.2	51.1	54.4	..	..	..	..	..	..
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	45.2	46.3	..	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	34.9	35.4	..	..	..	..	..	..	..
	% of GDP (based on EUR), period total								
Trade balance	–0.8	0.5	0.5	–0.7	0.9	1.0	1.5	–0.6	0.1
Services balance	2.2	2.5	3.2	2.5	2.2	3.0	3.7	3.2	3.1
Primary income	–3.4	–3.5	–3.7	–4.3	–3.6	–3.7	–3.9	–4.3	–3.2
Secondary income	–0.1	–0.2	–0.3	0.1	–0.4	–0.5	0.1	–0.3	–0.3
Current account balance	–2.1	–0.6	–0.3	–2.4	–0.8	–0.2	1.3	–2.0	–0.3
Capital account balance	2.4	2.4	1.1	4.4	0.7	2.5	0.0	0.0	1.7
Foreign direct investment (net)	–2.4	–2.1	–1.0	–2.5	–2.8	–3.3	–1.2	–1.3	1.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	71.4	70.3	74.8	72.4	70.3	70.2	72.9	74.4	74.8
Gross official reserves (excluding gold)	19.3	19.5	24.6	20.6	19.5	19.8	22.4	22.6	24.6
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.0	5.0	6.1	5.3	5.0	5.1	5.7	5.7	6.1
	EUR million, period total								
GDP at current prices	410,921	429,663	424,521	105,006	119,446	98,115	102,792	104,529	119,085

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

9 Romania: expansionary fiscal and income policies continue

Growth structure changes in second half of 2016

Real GDP growth remained brisk in the second half of 2016, even though domestic demand moderated somewhat. After peaking in the second quarter of 2016, private consumption growth decelerated despite continued strong real wage growth and a falling unemployment rate. Gross fixed capital formation declined year on year after having recorded robust growth in the first half of the year. This development was partly related to one-off effects: Against the background of discussions about the giving-in-payment law, demand for housing loans under the government's first home program spiked in the first half of 2016. Although the government raised the guarantee ceiling in September and November, the bulk of loans under this arrangement were granted in the first half of the year. Moreover, EU-funded projects under the 2007–2013 programing period were completed in the first half of 2016 and the implementation of projects financed by EU funds under the 2014–2020 programing period has not picked up sufficiently to sustain the momentum so far. Slowing domestic demand growth resulted in markedly lower import growth, counterbalancing the overall impact on GDP growth. As exports performed remarkably well, the contribution of net exports turned positive.

Fiscal policy remains expansionary, triggering warnings from European Commission and IMF

The budget deficit increased to 3% of GDP in 2016 (inter alia due to a VAT tax cut and increases in public wages). The new government's budget plan, which is based on a rather optimistic GDP growth forecast of 5.2% for 2017, envisages the deficit to reach 2.99% in 2017. While a further VAT tax cut (to 19% from 20%) became effective in January 2017, the government opted for a further rise in the minimum wage, public wages and pensions after parliamentary elections in December 2016. The European Commission stressed the risk that Romania might exceed the 3% limit for budget deficits in 2017 and 2018 in a letter to the Romanian finance minister. Moreover, IMF staff raised concerns regarding the country's fiscal policy during the Article IV consultations in March 2017.

It is worth noting that the constitutional court ruled that the giving-in-payment law must respect the civil code, meaning i.a. that in case of a default, debtors must prove that they entered into default because of unpredictable circumstances. Moreover, the constitutional court decided that the law on the conversion of Swiss franc loans was unconstitutional. Both laws had been adopted by parliament in 2016.

External debt ratio ceases to decline

The current account deficit widened only slightly in the second half of 2016. Yet, unit labor costs in the manufacturing sector continued to rise noticeably, as considerable labor cost increases outpaced modest productivity gains by a wide margin. As the Romanian leu only depreciated marginally against the euro, external price competitiveness weakened further. While the capital account surplus declined as a result of lower EU fund flows, net FDI inflows fell below the levels seen in the first half of the year. All in all, the deterioration in the basic balance prevented the external debt ratio from preserving its downward trend.

Inflation turns positive

Annual CPI and HICP inflation rates hovered around zero since autumn 2016 and ended up in slightly positive territory in early 2017. The Banca Națională a României (BNR) has kept its policy rate unchanged at 1.75% since May 2015. The BNR pointed to new disinflationary supply-side shocks that emerged from November 2016 to February 2017 (price cuts for compulsory motor third-party liability insurance policies and the scrapping of non-tax fees and charges, which add to the 1 percentage point VAT reduction). It expects inflation to re-enter the target variation band of 2.5% ±1 percentage point toward the end of 2017.

Table 9

Main economic indicators: Romania

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	3.1	3.9	4.8	3.8	4.0	4.3	6.0	4.3	4.8
Private consumption	4.5	5.9	7.5	6.2	7.2	9.1	10.4	6.7	4.5
Public consumption	0.9	0.2	5.1	1.5	–1.5	–0.4	1.9	1.8	14.6
Gross fixed capital formation	3.8	7.2	–2.2	1.5	17.1	1.0	6.0	–1.0	–14.2
Exports of goods and services	8.3	5.3	8.1	4.0	1.1	5.3	8.6	7.9	11.2
Imports of goods and services	8.1	9.4	10.1	9.9	6.5	10.1	13.7	7.7	8.7
	Contribution to GDP growth in percentage points								
Domestic demand	3.4	5.5	5.5	5.1	3.8	7.5	5.9	4.8	4.5
Net exports of goods and services	–0.3	–1.6	–0.7	–1.9	–0.9	–2.5	–2.3	0.4	0.7
Exports of goods and services	3.2	2.2	3.4	1.4	0.8	1.7	4.0	3.3	4.2
Imports of goods and services	–3.5	–3.8	–4.1	–3.3	–1.7	–4.2	–6.2	–2.9	–3.5
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per person)	3.7	–3.6	5.6	–2.3	–5.9	4.9	8.6	2.1	6.4
Unit labor costs in manufacturing (nominal, per hour)	–0.6	6.9	9.9	8.0	6.9	10.1	12.6	9.2	7.7
Labor productivity in manufacturing (real, per hour)	5.8	–0.3	–0.2	–1.1	0.2	–2.3	–1.7	1.2	1.8
Labor costs in manufacturing (nominal, per hour)	5.3	6.6	9.7	6.7	7.1	7.7	10.7	10.6	9.7
Producer price index (PPI) in industry	–0.1	–2.2	–1.8	–2.6	–2.3	–2.9	–2.6	–1.9	0.1
Consumer price index (here: HICP)	1.4	–0.4	–1.1	–1.5	–1.0	–2.0	–2.1	–0.1	–0.1
EUR per 1 RON, + = RON appreciation	–0.6	0.0	–1.0	–0.3	–0.5	–0.9	–1.2	–0.8	–1.1
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	7.1	7.1	6.1	6.8	6.8	6.8	6.1	5.9	5.6
Employment rate (%, 15–64 years)	61.0	61.4	61.6	63.2	61.4	59.8	61.8	63.1	61.6
Key interest rate per annum (%)	3.3	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.8
RON per 1 EUR	4.4	4.4	4.5	4.4	4.5	4.5	4.5	4.5	4.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	8.4	9.3	9.7	8.4	9.3	9.9	13.1	12.2	9.7
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	26.6	17.8	17.3	4.4	5.5	7.0	11.3	13.7	10.8
Domestic credit of the banking system	–10.9	0.7	2.4	3.3	5.4	2.8	2.7	–1.4	–2.7
of which: claims on the private sector	–6.3	0.0	3.5	0.5	2.5	2.4	1.0	1.0	0.9
claims on households	–1.1	1.9	4.2	1.5	2.2	2.2	2.1	2.5	1.8
claims on enterprises	–5.2	–2.0	–0.7	–1.0	0.3	0.2	–1.1	–1.5	–0.9
claims on the public sector (net)	–4.7	0.7	–1.1	2.7	2.9	0.4	1.8	–2.3	–3.6
Other assets (net) of the banking system	2.3	0.0	0.2	0.6	–1.5	0.2	–1.0	–0.1	1.6
	% of GDP								
General government revenues	33.5	35.0	31.7	. .	. .	. .	. .	. .	. .
General government expenditures	34.9	35.8	34.7	. .	. .	. .	. .	. .	. .
General government balance	–1.4	–0.8	–3.0	. .	. .	. .	. .	. .	. .
Primary balance	0.2	0.8	–1.5	. .	. .	. .	. .	. .	. .
Gross public debt	39.4	38.0	37.6	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	44.7	43.1	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	17.9	17.2	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–4.2	–4.9	–5.5	–4.7	–5.8	–5.7	–5.8	–5.0	–5.5
Services balance	3.9	4.3	4.5	4.4	3.7	5.6	4.9	4.1	3.8
Primary income	–1.3	–2.4	–2.8	–2.2	–1.9	–2.4	–4.8	–2.3	–2.1
Secondary income	1.1	1.8	1.4	1.3	2.1	1.7	1.5	1.7	1.0
Current account balance	–0.4	–1.1	–2.4	–1.2	–1.9	–0.9	–4.2	–1.6	–2.8
Capital account balance	2.6	2.4	2.5	2.0	1.8	4.0	3.2	2.5	1.0
Foreign direct investment (net)	–1.8	–1.7	–2.3	–2.2	–0.4	–4.1	–3.1	–1.1	–1.5
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	61.8	56.5	54.6	56.8	56.5	55.3	54.6	54.6	54.6
Gross official reserves (excluding gold)	21.3	20.2	20.2	18.5	20.2	19.4	19.3	20.0	20.2
	Months of imports of goods and services								
Gross official reserves (excluding gold)	6.2	5.8	5.7	5.3	5.8	5.5	5.5	5.7	5.7
	EUR million, period total								
GDP at current prices	150,488	159,978	169,567	44,540	47,429	32,594	39,733	46,453	50,787

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

10 Turkey: economic growth wanes in the wake of political fragility

Sizeable and broad-based deceleration of GDP growth

Following a robust expansion by 4.9% in the first half of 2016, Turkish GDP growth slipped into negative territory in the third quarter of 2016 (–1.3%) for the first time since 2008. On a positive note, a rebound of economic growth by 3.5% in the fourth quarter of 2016 still kept the decline of GDP growth in check. Yet, on an annual basis GDP growth more than halved to 2.9% in 2016. Private consumption edged up by 2% in the second half of 2016 on the back of robust retail credit activity and frontloaded consumer spending owing to an expected further currency depreciation and planned tax hikes on fuel and despite a spike in the unemployment rate to 12.2%. At the same time, government spending, although slowing down during the second half of 2016, posted the highest expansion (3.2%) of all GDP components. By contrast, private investment growth remained modest at best, held back by the deceleration of corporate credit activity and currency depreciation, which weighed on corporate balance sheets.

The fiscal stance turned expansionary in 2016. The government's budget balance slipped into negative territory in the second half of 2016, resulting in a deficit of 0.9% of GDP in 2016. Gross public debt slightly declined to 26.4% of GDP in 2016 although refinancing costs were on the rise as political uncertainty increased.

External imbalances reversed their narrowing trend

Unlike in previous years, net exports exerted a drag on GDP growth in the second half of 2016. Export growth dug further into negative territory (–3.5%) despite the partial lifting of sanctions with Russia and the continuous economic recovery in the EU, which was not able to balance off the slump in tourist arrivals in Turkey. At the same time, imports surged, spurred by a pickup in consumption and real effective exchange rate appreciation. The current account deficit widened moderately to 3% of GDP in the period from July to December 2016 (compared with the same period of 2015), but remained flat at 3.8% of GDP for 2016 on an annual basis. Net FDI inflows amounted to 1.2% of GDP in the second half of 2016, thus covering only 32% of the current account deficit. Accordingly, the Turkish economy continued to be highly reliant on more volatile portfolio inflows and loans, which turned partially negative during 2016. Gross external debt is on a steady upward trend and stood at 50.6% of GDP at end-2016. Gross external financing needs remain elevated and are projected to come close to 30% of GDP in 2017.

Inflation shot up, driven by strong depreciation of Turkish lira

The rate of depreciation of the Turkish lira rocketed, coming to 18.6 % against the U.S. dollar (16% against the euro) between end-September 2016 and end-March 2017. The risks for a further depreciation are high, given geopolitical and domestic uncertainty and slowing economic growth. In the fourth quarter of 2016, annual inflation (CPI) increased somewhat due to higher unprocessed food prices in parallel to continuously mounting energy and oil prices, recent tax hikes, particularly of fuel, as well as exchange rate pass-through effects. CPI edged up to 8.5% on an annual basis in December 2016, which was well above the year-end target of 5%, and most recently spiked to 9.9% in February 2017.

CBRT started to tighten monetary stance

With the view to countering strong depreciation pressures, the Central Bank of the Republic of Turkey (CBRT) started tightening its monetary stance in November 2016 by raising its policy rate, i.e the one-week repo rate, by 50 basis points to 8%. By March 2017, it had lifted the marginal funding rate in two steps (by 75 basis points) to 9.25% and the late liquidity window lending rate in three steps (by 175 basis points) to 11.75%. In January 2017, the CBRT announced an upward revision of the inflation forecast for 2017 to 8%; the year-end inflation target remains unchanged at 5%.

Table 10

Main economic indicators: Turkey

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	5.2	6.1	2.9	5.9	7.4	4.5	5.3	–1.3	3.5
Private consumption	3.0	5.5	2.3	3.7	5.4	0.9	4.1	–1.7	5.7
Public consumption	3.1	4.1	7.3	0.9	11.6	10.5	14.4	5.6	0.8
Gross fixed capital formation	5.1	9.2	3.0	9.1	10.4	6.6	3.8	0.5	2.0
Exports of goods and services	8.2	4.2	–2.0	4.7	5.2	1.4	–1.9	–9.3	2.3
Imports of goods and services	–0.4	1.7	3.9	0.5	0.4	2.7	7.2	2.1	3.3
	Contribution to GDP growth in percentage points								
Domestic demand	3.7	6.5	3.3	4.8	8.1	3.8	5.6	–0.2	4.2
Net exports of goods and services	1.8	0.5	–1.3	0.9	1.0	–0.4	–2.1	–2.4	–0.3
Exports of goods and services	1.7	0.9	–0.4	1.0	1.1	0.3	–0.4	–2.0	0.5
Imports of goods and services	0.1	–0.4	–0.9	–0.1	–0.1	–0.7	–1.7	–0.4	–0.7
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit wage costs in manufacturing (nominal, per hour)	12.9	10.6	14.9	12.0	7.9	13.9	15.4	17.4	12.9
Labor productivity in manufacturing (real, per hour)	1.3	4.1	2.9	4.4	5.5	5.4	2.8	0.3	3.5
Gross wages in manufacturing (nominal, per hour)	14.3	15.0	18.2	16.9	13.8	20.1	18.5	17.7	16.8
Producer price index (PPI) in industry	10.2	5.3	4.3	6.3	5.6	4.7	3.2	2.9	6.4
Consumer price index (here: HICP)	8.9	7.7	7.7	7.4	8.2	8.5	6.7	7.9	7.6
EUR per 1 TRY, + = TRY appreciation	–12.9	–3.8	–9.6	–9.8	–11.3	–14.6	–9.8	–3.9	–10.2
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	10.1	10.5	11.1	10.3	10.6	11.0	9.6	11.4	12.2
Employment rate (%, 15–64 years)	49.5	50.2	50.7	51.1	50.0	49.4	52.0	51.1	50.1
Key interest rate per annum (%)	8.7	7.6	7.5	7.5	7.5	7.5	7.5	7.5	7.7
TRY per 1 EUR	2.9	3.0	3.3	3.2	3.2	3.2	3.3	3.3	3.5
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	11.8	16.2	17.8	20.4	16.2	13.2	12.0	7.7	17.8
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	–10.8	–6.5	0.0	–2.8	–2.3	–0.1	1.5	0.6	1.9
Domestic credit of the banking system	57.7	48.6	47.4	27.9	24.3	19.1	16.2	11.9	19.9
of which: claims on the private sector	58.6	47.2	46.1	28.9	23.6	17.8	15.1	10.4	19.4
claims on households	11.4	5.7	6.4	3.4	2.9	2.2	2.1	1.9	3.0
claims on enterprises	47.2	41.5	39.7	25.5	20.7	15.6	13.0	8.4	16.3
claims on the public sector (net)	–0.9	1.4	1.3	–1.0	0.7	1.3	1.1	1.6	0.5
Other assets (net) of the banking system	–11.7	–12.2	–10.4	–4.7	–5.7	–5.8	–5.6	–4.8	–4.0
	% of GDP								
General government revenues	. .	. .	. .	. .	. .	. .	. .	. .	. .
General government expenditures	. .	. .	. .	. .	. .	. .	. .	. .	. .
General government balance	0.1	1.3	–0.9	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	28.6	27.5	26.4	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	–6.8	–5.6	–4.8	–5.5	–4.8	–4.4	–5.5	–4.8	–4.4
Services balance	2.9	2.8	1.8	4.9	2.1	0.9	1.4	3.2	1.5
Primary income	–0.9	–1.1	–1.0	–0.8	–0.9	–1.0	–1.2	–1.0	–1.0
Secondary income	0.2	0.2	0.2	0.1	0.2	0.3	0.2	0.1	0.3
Current account balance	–4.7	–3.8	–3.8	–1.2	–3.4	–4.1	–5.2	–2.4	–3.7
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	–0.6	–1.4	–0.9	–2.0	–1.0	–0.7	–0.4	–1.1	–1.3
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	50.8	48.7	50.6	48.7	48.7	48.6	50.8	50.2	50.6
Gross official reserves (excluding gold)	12.4	11.1	11.3	11.8	11.1	11.0	11.9	11.5	11.3
	Months of imports of goods and services								
Gross official reserves (excluding gold)	5.4	5.1	5.4	5.3	5.1	5.1	5.6	5.6	5.4
	EUR million, period total								
GDP at current prices	705,229	771,556	773,618	199,011	202,775	172,811	193,547	200,056	207,204

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

11 Russia: from waning recession to weak recovery

GDP stagnates, inventory buildup and exports support economic activity

According to latest data revisions of the Russian statistical office (Rosstat), Russia's recession of 2015–2016 was milder than previously assumed: Thus, GDP in 2015 declined by 2.8% year on year (instead of an estimated 3.7%), and economic activity in 2016 eased by 0.2% (instead of an estimated 0.6%). Thus, GDP in 2016 effectively stabilized. Revised quarterly data show small economic contractions from the first to the third quarter 2016 year on year, while the fourth quarter is assessed to have registered weak growth. The revisions reportedly reflect an adjustment in the base year of calculations (2011 instead of the crisis year 2008) and better data on the operations of SMEs as well as on industrial production.

CBR's continued tight monetary policy and some transient factors bring inflation down

The decrease of private consumption and fixed investment continued to slow down, while the inventory cycle turned positive and stocks were built up again. Another positive contribution to economic activity was furnished by expanding real exports, while imports further contracted in real terms. Russia's economy stabilized in 2016 despite ongoing sanctions of Western countries and a further drop in the Urals grade oil price by about 18% on average over the previous year, which seems to reflect a degree of adaptation to the lower oil price environment. This adjustment was probably helped by the flexible exchange rate of the Russian ruble, which depreciated about 10% against the U.S. dollar in 2016. The Central Bank of Russia's (CBR) continued tight monetary policy (the CBR held the key repo auction rate at 10% from September 2016 to March 2017), the country's 2016 record harvest and the partial revaluation of the Russian ruble in recent months contributed to further reducing inflation to 4.3% in March 2017 – a five-year low. The CBR thus decided to slightly cut its key policy rate in mid-March to 9¾%.

Further oil price drop in 2016 erodes Reserve Fund

The further oil price decline in 2016 contributed to driving up the federal budget deficit to 3.4% of GDP that year (from 2.4% of GDP in 2015). As in 2015, the lion's share (about three-quarters) of the shortfall was covered by the Reserve Fund, whose level fell further to about 1.2% of annual GDP at end-February 2017. The remainder was financed on the domestic debt market and via privatization proceeds. The Reserve Fund could be exhausted in the course of 2017. By contrast, the assets of the National Wealth Fund, whose main purpose is to support the pension system, have remained stable over 2016 and early 2017 (around 5.4% of GDP at end-February).

Marked decrease in current account surplus accompanied by low capital outflows

The oil price-triggered further contraction of exports (valued in U.S. dollars) and the much slower contraction of imports combined to cut the current account surplus to 1.9% of GDP in 2016 (as against 5.0% in 2015). Net private capital outflows fell to USD 19 billion (1.5% of GDP), the lowest outflow for almost a decade. The strong shrinkage of net capital outflows is largely attributable to declining debt service payments and to the partial privatization of the oil company Rosneft in December.

NPLs remain high; bank profitability is improving

Given the further depreciation of the Russian ruble in 2016, the stagnation of the economy and the still high ratio of NPLs (18.9% at end-2016 based on a broad definition including doubtful loans), lending contracted by 7% in the twelve months to end-February 2017 (in real terms and exchange rate-adjusted), while deposits expanded by 6%. Recovering interest margins have helped banks' profitability to increase from a modest level. The country's international reserves (excluding gold) slightly expanded in 2016.

Table 11

Main economic indicators: Russia

	2014	2015	2016	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
	Year-on-year change of the period total in %								
GDP at constant prices	0.7	–2.8	–0.2	–2.7	–3.2	–0.4	–0.5	–0.4	0.3
Private consumption	2.0	–9.7	–4.5	–9.9	–11.3	–4.2	–5.9	–4.8	–3.2
Public consumption	–2.1	–3.1	–0.5	–3.1	–3.1	–0.4	–0.5	–0.5	–0.5
Gross fixed capital formation	–0.4	–9.9	–1.8	–13.1	–10.5	–7.0	–1.5	–0.8	–0.3
Exports of goods and services	0.5	3.7	3.1	–0.9	9.1	–0.4	4.9	4.2	3.7
Imports of goods and services	–7.3	–25.8	–3.8	–25.5	–21.4	–8.0	–4.6	–3.5	0.3
	Contribution to GDP growth in percentage points								
Domestic demand	–0.2	–8.6	–2.1	–7.4	–9.2	–2.1	–2.8	–2.5	–1.1
Net exports of goods and services	1.7	6.2	1.5	5.2	6.3	1.1	2.2	1.8	1.0
Exports of goods and services	0.1	1.1	1.0	–0.3	2.4	–0.1	1.5	1.2	1.1
Imports of goods and services	1.6	5.2	0.6	5.5	3.9	1.2	0.7	0.6	–0.1
	Year-on-year change of the period average in %								
Unit labor costs in the whole economy (nominal, per hour)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Unit labor costs in industry (nominal, per person)	5.6	7.3	5.5	5.8	6.2	5.2	3.7	7.1	5.9
Labor productivity in industry (real, per person)	3.5	0.8	3.4	0.9	1.2	3.9	3.6	3.1	3.1
Average gross earnings in industry (nominal, per person)	9.2	8.0	9.1	6.7	7.4	9.4	7.5	10.4	9.2
Producer price index (PPI) in industry	6.1	12.4	4.2	12.9	13.1	4.4	3.6	3.9	5.0
Consumer price index (here: CPI)	7.8	15.6	7.1	15.7	14.5	8.4	7.4	6.8	5.7
EUR per 1 RUB, + = RUB appreciation	–17.0	–25.0	–8.4	–31.8	–17.2	–13.8	–21.8	–2.3	6.5
	Period average levels								
Unemployment rate (ILO definition, %, 15–64 years)	5.2	5.6	5.5	5.3	5.7	5.9	5.7	5.3	5.4
Employment rate (%, 15–64 years)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Key interest rate per annum (%)	7.9	12.6	10.6	11.2	11.0	11.0	10.9	10.4	10.0
RUB per 1 EUR	51.0	68.0	74.2	70.5	72.4	82.5	74.4	72.1	68.0
	Nominal year-on-year change in the period-end stock in %								
Broad money (including foreign currency deposits)	14.8	19.7	–0.9	23.0	19.7	15.9	14.3	5.7	–0.9
	Contributions to year-on-year change of broad money in percentage points								
Net foreign assets of the banking system	24.0	39.3	5.4	27.4	18.2	15.4	12.5	–1.1	–10.7
Domestic credit of the banking system	42.1	40.4	23.4	22.4	16.7	15.6	14.8	10.9	5.6
of which: claims on the private sector	52.0	42.3	9.9	23.4	10.6	8.9	8.9	3.8	–0.6
claims on households	12.2	2.3	–1.4	–0.8	–1.6	–0.9	–0.3	–0.1	0.2
claims on enterprises	39.7	40.0	11.3	24.2	12.2	9.8	9.2	3.9	–0.8
claims on the public sector (net)	–9.9	–2.0	13.6		6.2	6.8	6.0	7.1	6.2
Other assets (net) of the banking system	–32.8	–42.2	–10.2	–26.8	–15.3	–15.2	–13.1	–4.1	4.2
	% of GDP								
General government revenues	33.8	32.3	32.2	. .	. .	. .	. .	. .	. .
General government expenditures	34.9	35.7	35.9	. .	. .	. .	. .	. .	. .
General government balance	–1.1	–3.4	–3.7	. .	. .	. .	. .	. .	. .
Primary balance	. .	. .	. .	. .	. .	. .	. .	. .	. .
Gross public debt	13.0	13.2	12.9	. .	. .	. .	. .	. .	. .
	% of GDP								
Debt of nonfinancial corporations (nonconsolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
Debt of households and NPISHs (nonconsolidated)	. .	. .	. .	. .	. .	. .	. .	. .	. .
	% of GDP (based on EUR), period total								
Trade balance	9.1	10.9	7.0	8.4	8.7	8.9	7.2	5.2	7.1
Services balance	–2.7	–2.7	–1.8	–3.5	–2.0	–1.8	–2.0	–2.0	–1.6
Primary income	–3.3	–2.7	–2.7	–2.0	–2.1	–1.5	–4.3	–2.4	–2.5
Secondary income	–0.4	–0.4	–0.5	–0.5	–0.4	–0.5	–0.4	–0.7	–0.4
Current account balance	2.8	5.0	2.0	2.3	4.2	5.1	0.6	0.1	2.6
Capital account balance	–2.1	0.0	–0.1	0.0	0.0	0.0	–0.4	0.0	0.1
Foreign direct investment (net)	1.7	1.2	–0.8	2.4	0.2	3.1	–0.1	–0.6	–4.1
	% of GDP (rolling four-quarter GDP, based on EUR), end of period								
Gross external debt	31.4	38.7	41.6	37.3	38.8	38.4	41.9	41.3	41.6
Gross official reserves (excluding gold)	17.9	23.9	25.7	22.5	23.9	24.1	26.2	26.3	25.7
	Months of imports of goods and services								
Gross official reserves (excluding gold)	10.4	13.9	15.0	12.8	13.9	14.2	14.9	15.1	15.0
	EUR million, period total								
GDP at current prices	1,558,123	1,230,279	1,172,299	311,775	315,617	228,146	274,771	315,170	354,212

Source: Bloomberg, national statistical offices, national central banks, wiiw, OeNB.

Box 2

Ukraine: new reform impetus needed to safeguard recovery

Economic activity sped up in the second half of 2016, bringing full-year growth to 2.3%. The modest recovery was driven by domestic demand (in particular gross fixed capital formation), which strengthened in the second half of 2016. In parallel, growth figures of external trade reversed. In the final quarter, gross exports went up year on year for the first time in six years. A bumper harvest with agricultural output at constant prices rising by 6% in 2016 and 18.4% year on year in the final quarter supported exports and overall GDP growth. However, as imports started to upsurge from mid-2016, net exports continued to contribute negatively to growth in the second half of 2016. Due to a widening trade deficit, the current account deficit climbed to 4.1% of GDP in 2016.

After falling to single digits in the course of 2016, inflation accelerated to 15.1% in March 2017, partly because of higher energy prices. Nevertheless, the National Bank of Ukraine (NBU) sees its inflation targets for 2017 and 2018 (8% ±2 percentage points and 6% ±2 percentage points, respectively) within reach. It had cut the key policy rate by 100 basis points to 14% in October 2016 and has left it unchanged since then. The budget deficit amounted to 2.3% of GDP in 2016 and was thus below the target of 3.7% agreed with the IMF under the Extended Fund Facility. Public debt remained relatively high (81% of GDP at end-2016), however. In line with the IMF program, parliament approved a budget for 2017 that envisages a deficit of 3.1% of GDP.

On April 3, 2017, the IMF Executive Board completed its third review of Ukraine's economic program under the Extended Fund Facility, enabling the disbursement of about USD 1 billion to Ukraine, bringing total disbursement to about USD 8.4 billion out of the available total of USD 17.5 billion. Rebuilding foreign currency reserves (USD 15.1 billion at end-March, i.e. before disbursement) remains critical in light of the still high gross external debt stock (USD 113 billion at end-2016). The nationalization of the largest Ukrainian bank (Privatbank) in December 2016 was a priority for the Ukrainian authorities and a required prior action for the completion of the third review. It is noteworthy that the NBU's governor resigned in April 2017. The IMF praised her for her work, inter alia for the progress made in cleaning up the banking sector. As Ukraine has missed several structural benchmarks (in particular regarding pension, land and state-owned enterprise reforms), the IMF wants to see material progress on the structural reform agenda in 2017. The IMF also called for further measures and concrete results in the fight against corruption.

The IMF Executive Board meeting on the third review of Ukraine's economic program under the Extended Fund Facility took place two weeks later than initially scheduled. In particular, IMF staff needed time to assess the negative economic impact of the Ukrainian government's decision to suspend trade with the non-government controlled area. The trade blockade and other largely interrelated events (blockage of rail lines, seizure of Ukrainian assets by separatists, recognition by Russia of identity cards issued in separatist areas, physical attacks on Russian state-owned banks in Ukraine) illustrate that the environment has remained shaky given the unresolved conflict in parts of Eastern Ukraine. On the ground, the OSCE special monitoring mission has continuously reported ceasefire violations along the contact line. Hardly any progress has been made regarding the overall conflict settlement package agreed in Minsk in February 2015.